Investment Insight

A FOCUS ON QUALITY AND DIVERSIFICATION SHINES THROUGH – A REVIEW OF 2024 AND THE OUTLOOK FOR 2025

In 2024, our World Stars Global Equity strategy performed strongly despite macroeconomic and geopolitical challenges thanks to its focus on quality and the diversification of the underlying drivers of value for our stock holdings.

The industrial sector benefited from key structural trends like the transition to net zero, reshoring, and AI infrastructure, with companies like *Eaton* and *Amphenol* excelling. Amphenol, in particular, thrived due to its diverse exposure across end markets, including AI and 5G, providing strong growth potential despite short-term issues in other sectors. Looking ahead, we expect the industrial sector to continue evolving, underpinned by the need to invest in the efficiency, capacity and sustainability of public and private infrastructure.

In the technology sector, AI remained the dominant theme, with *Nvidia* leading the way. The company's quality products and robust product ecosystem positioned it to exceed expectations. *Meta* also posted strong returns, leveraging AI to enhance its advertising model. As AI continues to expand, the sector's valuation remains attractive, particularly with the emergence of agentic AI, which we expect to be a major growth driver in 2025.

The consumer sector faced challenges due to inflation, high interest rates and weak demand, but valuations have become more appealing. Companies like *Diageo*, with a diversified portfolio, are expected to recover as supply chain issues ease.

In healthcare, while policy uncertainty remains, quality innovation in companies like *EssilorLuxottica* positions them well for growth. The company's strategic diversification into eyewear, hearing solutions and smart eyewear adds significant growth potential to its core business.

We believe the quality of our companies will enable them to remain resilient in a challenging year, while their growth opportunities and attractive valuations make us optimistic that they will continue to offer strong prospects for value generation.

Industrials

In a year dominated by macroeconomic and geopolitical events, the industrial sector demonstrated resilience and adaptability by aligning closely with key structural themes. The transition to net zero, the reshoring of critical industries, the modernisation of aged infrastructure, the need to automate to replace scarce and expensive labour and a structural step up in defence spending is set to fuel the sector for decades.

At the same time, capital investments in AI and data centres, where energy constraints are critical considerations, gathered pace during 2024 providing an additional pillar of growth. This accelerating momentum is most visible in mega project activity in the US (projects over USD 1 billion in value), which at the end of the 3rd quarter stood at USD 1.6 trillion since January 2021 and up from USD 600 billion since the 1st quarter of 2023.

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Industrial companies providing power management and connectivity solutions were among the primary beneficiaries of this momentum. *Eaton,* highlighted in our December *Investment Insight* last year, was our top-performing industrials holding this year, closely followed by Amphenol.

Amphenol – benefiting from the 'electrification of everything'

Amphenol*,* a leading supplier in interconnect and sensor solutions is up 50% year-to-date, as a key beneficiary of the 'electrification of everything' and the proliferation of electronics across end markets. The company's diversification, with no end market accounting for more than 25% of sales, makes it particularly attractive because it allows the company to participate in structural trends across applications and provides a shield from short weakness in any single one.

Growth during 2024 was particularly robust in its IT and datacom division. It accounted for 25% of sales and was up more than 50% in the past several quarters, fuelled by the demand for AI-related applications.

Next-generation AI systems are more interconnect-rich and require high-speed, low-latency and power-efficient designs to support the dense AI computer racks. Amphenol has been investing in the space in terms of product development in recent years and is now able to leverage the benefits of that with the broadest and deepest connector offering in the data centre market.

At the same time, other areas of the company's business like mobile networks are seeing increasing demand from structural investments in 5G network infrastructure. Within its commercial aerospace and military businesses demand has benefited from robust end-market trends and higher content in the next-generation platforms. On the weaker side this year has been the company's industrial end market, accounting for 23% of sales, which has been seeing elements of destocking at the distributor level, but continues to benefit from the digitalisation of physical asset infrastructure, and which is set to accelerate in 2025 as some these short-term headwinds fade.

Source: Amphenol. 'Leading interconnect technologies'. Baird Global Industrial Conference, November 2024.

Importantly, the company can invest the cash from its rapidly growing business into accretive acquisitions, further expanding its competitive offering across end markets and deepening its competitive moat. It has made over 50 acquisitions in the last decade and 13 acquisitions over the past two years, including the two largest in its history, which alone added USD 2.1 billion in incremental sales, continuing this virtuous circle.

Looking into 2025, we expect the industrial sector to continue being shaped by advanced new applications, strategic supply chain shifts and a focus on resilience amidst geopolitical volatility. The integration of AI, energy-efficient technologies and digital tools across manufacturing and infrastructure will remain central. Policy incentives driving reshoring and nearshoring, only accelerating under a new US administration, are set to benefit companies positioned to capitalise on these trends.

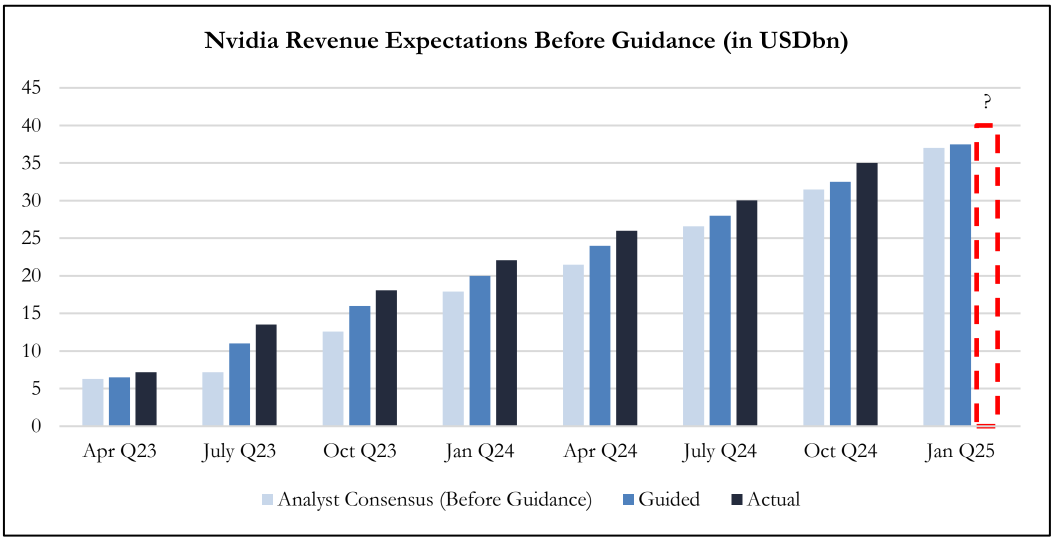
Technology

Reading this review of the technology sector for 2024 might seem like déjà vu all over again given our continued focus on the AI revolution and Nvidia's strong share performance. Having previously written that Nvidia would benefit from a significant infrastructure build-out, 2024 was a continuation of 2023, as we had anticipated. Its shares climbed over 170% over the year.

Nvidia – continuing to lead the AI phenomenon

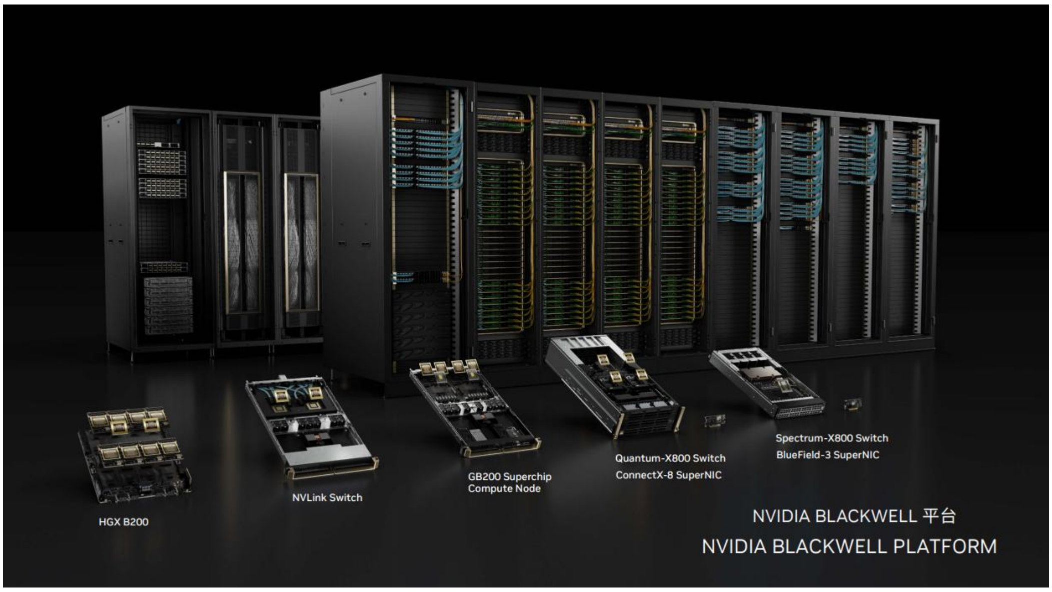
Revolutions do not occur overnight, and AI is going to be a structural shift for the next decade and beyond. Hyperscalers, large enterprises and governments around the world are all envisioning what AI can do and they are quickly building out their capabilities. Nvidia retains a strong competitive advantage with an ecosystem that has taken years to build and its fast cadence of new products making it difficult for rivals to catch up.

The company has remained one of our highest conviction investments during the year, although we have had to reduce the position size on several occasions for portfolio and risk management reasons. Last year we wrote that the company was growing significantly faster than what Wall St was expecting. This year Wall St has been more accurately forecasting its potential.



Source: Nvidia, Citi, J. Stern & Co. estimates. Quarters based on calendar year, Nvidia's fiscal year ends 31st January

The company has been strongly exceeding these expectations with its reported results and there are very high expectations for the company going forward. However, we believe that it can continue to surprise on the upside as the Blackwell products will usher in a new scale of training models and capabilities.



Source: Nvidia

Mirroring 2023, our next best performer was Meta, up 85%. The success of the company in 2023 was the result of its resilient core business and aggressive cost cutting, which allowed it to deliver significant operating margin expansion. In 2024, it became the first large company at scale to incorporate AI and has subsequently seen significant benefits.

It is all about actual results. Meta delivers a superior return on ad spend for its customers, which in turn encourages the customer to spend more. AI has helped Meta to make the creative work of making adverts faster and easier, to target its adverts better, to deliver better conversion and to improve attribution metrics. The company has also developed its Llama Open-Source AI model that is on par, if not exceeding, some of the other large language models (LLMs) that are available.

Looking forward to 2025, we expect continued significant build out of AI infrastructure and that more applications and use cases of AI will make it easier for investors to appreciate the transformational potential of AI for business and society.

In particular, we expect to see the use of agents or agentic AI that can autonomously solve multi-step complex problems. We expect that this will be the next iteration of AI. Moving on from co-pilots which work alongside humans, agents will perform autonomous functions. For example, *Salesforce* (+35%) has experienced good early success signing up over 200 deals for its Agentforce product within the first week of general availability.

That is why heading into 2025, we anticipate further developments in agentic AI and a broader understanding that companies will no longer be able to ignore the AI revolution.

Consumer products

It has been a challenging year for our consumer holdings, with the threat of tariffs in the wake of the US presidential election creating volatility while the ramifications of the pandemic continued to linger. After a period of 'supernormal' growth during the pandemic years, the normalisation of growth that started in 2023 continued into 2024 across different consumer sectors.

Exacerbated by higher costs of carry from higher interest rates on one hand and weak demand from consumers, who felt the wallet pinch from the high inflation, on the other, we saw destocking across the supply chain from distributors to retailers in spirits.

In China, a weaker-than-expected economic recovery post-Covid re-opening and a downturn in the property sector led to low confidence amongst consumers and subdued consumption. This was despite Chinese consumers having a record level of savings. This mood was felt most acutely by the luxury sector where Chinese consumers had been a major growth driver in the past decade.

As we look ahead into 2025, we are optimistic about the recovery of the consumer sector. Two main factors, high inflation and high interest rates, which have weighed on the sector are abating. We expect the declining trend in inflation and interest rates across the major economies to continue through the course of 2025, which should be supportive of consumer sentiment.

In China, the stimulus announced in September is starting to show early signs of success in stabilising the property sector, a key psychological driver for consumer confidence as much of the Chinese households' wealth is tied to the property sector. We expect more stimulus measures, both monetary and fiscal, to come in 2025, which will support both broader consumption and the property sector.

We are also mindful of the potential implementation of tariffs on imports to the US by the incoming administration, which may create volatility in the near term. Tariffs will have a direct impact on those of our companies that produce 'distinctive' goods where the origin of the goods is also the DNA of the products they sell. For example, Scotch whisky is made in Scotland, tequila is made in Mexico and luxury goods are made in France or Italy. Goods made in China are not a major factor for the companies we invest in.

Based on our estimates, even with a 10% tariff across the world and a 25% tariff from Mexico and Canada (assuming the entirety of the impact is absorbed without offsets such as price increases or corporate tax cuts in the US) the impact on earnings of our companies is in the range of 1% to 7%. Our experience has been that companies can take appropriate measures to mitigate the impact of tariffs at least partially in the short term and more fully over the long term.

The incoming US administration tariff threat (ex-China) could be a real trade policy or a bargaining tool for something else. For example, is the 25% tariff threat on imports from Mexico and Canada a trade policy or is it designed as an opening position to support the new administration's immigration policy? We will not know this until the new administration takes office in January and begins to implement its policies.

The valuations of companies and their share prices have already de-rated significantly over the past year, although some have already started to recover from their lows around the election and the headline risk of the potential tariff since the US reaction. We expect volatility around tariff discussions but believe that much of the tariff risks have already been discounted in the share price.

Diageo – the light at the end of the tunnel

Diageo has been one of the core holdings in the World Star portfolio since 2016. It is the global leader in spirits with a 20% market share. The spirit market is a growing market driven by the premiumisation of spirits and a consumption shift from beer/wine to spirits in the developed markets and by income growth and increasing consumption of Western spirits in the emerging markets.

Diageo had generated a total annual return of 11-12% since we purchased the stock until the middle of 2023 when destocking across the supply chain in both the US and Latin America happened simultaneously. This led to lower sell-in revenues. Coupled with weaker consumer demand from high inflation, the company revised down its earnings and outlook for its financial year ending June 2025.

Source: Shutterstock
Don Julio tequila – Depletions +21% in North America in Diageo's FY2024, led by the super-premium Resposado

We believe these headwinds are short-term cyclical factors. The long-term growth drivers remain very much intact. Premiumisation continued despite weak consumer spending and growth of other emerging markets where destocking was not an issue were also resilient. In spite of a 3.5% volume decline in its FY2024 to end June, Diageo reported an increase of 2.9% in price/mix.

As we head into 2025, the inventory levels in both the US and Latin America are back within the historical normal range. Going forward, shipments should be broadly in line with the end market consumption. We believe that as the demand recovers so will Diageo's share price and that the company has passed the darkest moment of the destocking cycle and is on its path to a gradual return to normal growth.
Given the cheap valuation, which is several points below its historical average, we expect both earnings recovery and re-rating in 2025.

Healthcare

Innovation vs. US healthcare policy uncertainty

This year, the healthcare sector returned to its normal fundamentals after a period of dislocation during the Covid pandemic, during which revenues and earnings were more volatile. Surgical procedural volumes which reduced during the pandemic increased back to their historical trend. The difficult year-on-year comparisons from covid testing/treatment revenues also receded and the performance of our healthcare holdings improved.

Going into 2025, we expect the US new administration's policy on healthcare to be front and centre of investor focus. President-elect Trump has nominated Robert F. Kennedy Jr (RFKJ) to be his Health and Human Services (HHS) secretary and subsequently nominated like-minded candidates for the head of important US healthcare institutions like CMS, FDA CDC and NIH. If confirmed by the Senate next year, RFKJ and his team will have a far-reaching impact on the healthcare and food industries.

We do not yet know the exact policies RFKJ will implement, but based on his 'Make American Healthy Again' (MAHA) platform, we see several issues we will watch closely:

- Reform of the FDA and potential drug approval process including the Pharmaceutical Drug User Fee Act (PDUFA) as well as the possibility of approval of alternative therapies like psychedelics and response to epidemics of chronic diseases through alternative means such as diet and exercise rather than medical interventions.
- Food regulation potentially banning processed food from school lunches and removing additives and chemicals from the food supply chain.
- High staff turnover risk at the FDA, which may lead to delays in drug approvals.
- Potential changes to vaccination policy from mandatory to giving people choices.
- Reform of the NIH attempts at cutting costs, bureaucracy and duplications and the possible repurposing of some of the NIH funding from drug development to RFKJ's food agenda.
- Potentially revisit of Trump's 'most favoured nation' policy on drug pricing for Medicare and expansion of the basket of reference pricing to a lower level in drug negotiation with the industry under the IRA.

Looking beyond the near-term policy uncertainty and volatility from the incoming administration, we believe the need for innovative medicines and devices is not abating but on the contrary, it is more important in an environment of higher scrutiny. We are confident that companies that innovate to address unmet medical needs and make people healthy again are in tune with Trump's healthcare agenda and will ultimately be winners.

EssilorLuxottica – firing on all cylinders

EssilorLuxottica is a stock that we have owned in the World Stars portfolio since 2017 and it has generated an annual total return of 13-14% since. It is a global leader in eyecare in the design, manufacturing and distribution of prescription glasses, frames and sunglasses.

The company operates in a growing market. It is estimated that 53% of the world's population suffers from myopia or presbyopia, yet less than half of those wear some form of vision correction. For eye protection, statistics are even more startling. In an ideal world, everyone should be protected from the harmful UV lights and blue lights that cause cataracts, eyelid cancer or even age-related macular degeneration. In reality, less than 20% of the world's population wears any form of protection and we see significant room for increasing penetration, in particular in eye protection.

EssilorLuxottica is an innovator across the spectrum of eye care, from the Stellest myopia management solution that slows down the myopia progression in children to its newest varifocal lens Varilux XR and photochromic lens Transition Gen S. Together with its suite of frames from value to designers, the company continues to cement its leadership position in traditional eye care.

But its story does not stop here; the company continues to look for growth opportunities in its adjacent fields. For example, Ray-Ban Meta smart glasses have been a great success and have enabled the company to enter into a brand-new market of connected wear. These 'wearable tech' glasses enable users to take photos and videos, listen to music, makes calls and even livestream to Facebook and Instagram.

In September 2024, EssilorLuxottica and Meta extended their partnership started in 2019 to a long-term agreement. The two companies will collaborate over the next decade to develop multi-generational smart eyewear products and be the champions of smart wear.

EssilorLuxottica's recent acquisition (October 2024) of the lifestyle brand Supreme for US$1.5 billion opens the door to a new generation of younger streetwear consumers that have been harder to reach in the past.

The acquisition of Nuance Hearing in 2022 has allowed EssilorLuxottica to enter another new market; over-the-counter (OTC) hearing aids in glasses. Potentially 1.2 billion people worldwide need hearing solutions but existing hearing aids either do not suit them or people have a stigma about wearing them The new generation of OTC hearing aids in glasses provides people with mild hearing loss a new medical solution without the inconvenience and stigma attached to over-the-ear hearing aids. The device has already been filed with the FDA and the company expects an approval in the coming months and launch soon thereafter.

With Ray-Ban Meta smart wear, myopia management and Nuance OTC hearing aid in glasses, EssilorLuxottica is adding new platforms for growth whilst at the same time maintaining and growing its leadership in the core traditional business of lenses/frames and complete pairs. We believe the future for the company is bright.

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