Commentary

SHOOT FIRST, ASK QUESTIONS LATER…

It is always dangerous to extrapolate from personal experience to wider political, economic or social impacts, much less to investment views. Sometimes we must make an exception however…

Earlier this month in London, one of us was looking to buy a birthday gift for their 10 year-old son. Staying with friends over the weekend, they had seen the latest laser tag guns that no longer need an additional receiver that could get lost or broken (made by Hasbro, the US toy company, as they could not help noticing). However, busy with work, the acquisition was forgotten until the day before. We have all been there…

Given our strong views on digital transformation, Amazon was the first port of call. It had the toy but it was too late for delivery for the birthday. Hamleys, the Harrods' of toy stores, is on Regent Street a short walk from our office in Carlton Gardens, so that appeared the obvious solution. Hamleys has a website of its own and the price listed seemed reasonable for the convenience. It was late in the afternoon and the store was open until 9 pm. However, it was impossible to call and ask if they had it in stock because the customer service closed at 5 pm and the website did not provide the information.

Walking to Hamleys, five somewhat cheerless staff members had five different answers as to where to find the toy. After not quite half an hour of walking through the store and asking several more staff members, the laser tag gun was finally located. With a feeling of relief that will be familiar to most us, they bought it without inspecting the price. However, being focused on quality and value as we always are, walking out of the store, they looked up the item again on Amazon and were stunned. A toy that was available on Amazon for £24.99 for next day Prime delivery was sold in-store for £65.99. They quickly hurried back in and spent another half an hour returning it.

The next morning they had festive birthday breakfast and went on to the Amazon website to order not one but two of the toys (four guns in total) together. Tellingly, the 10 year-old was as thrilled if not more to be able to choose and buy it himself, and he walked off happily telling his friends at school about his birthday gift, which was as real to him after seeing the order placed on Amazon as it would have been if he had it in front of him. The laser tag guns were delivered the next day (a Saturday) and the house has been in chaos ever since…

The whole experience was a stark illustration of the strength of Amazon's business model and the ongoing disruption it is causing for traditional retail. We wrote earlier this year that for Jeff Bezos, 'your margin is my opportunity'. The toy industry has been the second most affected after Amazon's original target, media, music and books. 53% of toy sales in the US are now online. Toys'R'Us and a number of retailers are already gone and it is hard to see how Hamleys will survive with the customer proposition we experienced above. It failed on every aspect of the sales process apart from immediate availability, and the price difference was so significant that even a Londoner used to premium pricing thought it was excessive. Amazon has just announced that it is moving to free next day delivery for Prime members, which is a testament to its execution capability and will further extend its competitive advantage.

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The car industry has not been as disrupted by online sales—only 4% of US car sales are online so far. By the time the 10 year-old is 18, will they want a car for their birthday? Will they even bother getting a driver's license? Electric cars and autonomous driving have tremendous disruptive potential. With the IPOs of Lyft and Uber, ride hailing and ride sharing applications are coming into the mainstream with high valuations, great growth, large revenues and enormous losses. In our insight this month Driverless cars: Where are they Heading?, Giles Tulloch discusses the future of autonomous driving and how we think about its potential impact on society and on our portfolios (spoiler: it's still Google and Amazon…). You can click on the attachment or follow the link here.

As we write, it is not surprising to us that markets have now recovered and are back to the levels they were before the sell off at the end of last year. Many of our stocks are trading at their highs, several well above the levels of last year. We have said consistently that the fundamental outlook for the global economy, in particular in the US but also in Europe and in China, is sound. We passed a turning point last year, moving to slower but sustained growth and moderate inflation. Central banks have been reasonable and are working to balance growth and inflation. Importantly, most if not all of the companies in our portfolios are doing well.

We are in the middle of the quarterly reporting period and as we say below, they have been reporting good results and solid outlooks. Whether politics follow and enter a more stable trajectory as we hope, as economies do better, people feel more secure in their prospects for opportunity, employment and income, more hopeful and less discontent, remains to be seen. We stick with our conviction to take a long-term view and to look through the volatility, and are positive about the ability of our companies to prosper and to deliver value over time.

We would also like to take the opportunity to let you know about a recent development for our business. As you know, the World Stars Global Equity Strategy represents the core approach with which the Stern family has managed the largest proportion of its financial assets for the past 60 years, following Maurice Stern's proven investment principles of investing for the long-term based on proprietary research and a focus on quality. J. Stern & Co., the successor to the Stern family's banking and investment businesses, has been managing the World Stars Global Equity Strategy since October 2012 with the goal of generating returns of 8-10% per year or more over the long-term. Our clients invest alongside the Stern family and the partners based on those same principles and with a strong alignment of interest. Since inception the strategy has generated 10.1% per year. Over the last three years it has generated 13.3% per year (both in US Dollars to 31/03/19).*

We have been managing the World Stars Global Equity Strategy for our clients in separate accounts, held in their name at their private banks or other custodians. However, a number of investors have asked us if we could provide the strategy in a fund format because they prefer to invest in funds because of how they have structured their own investment, tax efficiency, ease of implementation and accessibility to a broader investor group.

This month we are pleased to announce that in response to these requests we have launched The World Stars Global Equity Fund. It is available now to anyone who can invest in a Luxembourg UCITS fund, as part of the Alpha UCITS SICAV platform, the leading Luxembourg UCITS platform.

Our new fund follows our World Stars Global Equity Strategy and has been structured following the principles which are at the heart of J. Stern & Co. It does not hedge markets

nor currencies, take short positions nor use leverage for the purpose of investing. The fund launched on 8 April 2019. The Stern family has seeded the Fund with more than USD 30 million. Current assets are USD 45 million. It is available in different share classes and can be found on Bloomberg and other pricing providers and more information is on our updated website.

We view the Fund as complementing our offering. We will continue to manage separate accounts for investors who wish to own their stocks directly and for who we can manage bespoke portfolios according to their preferences and requirements with as much discussion and involvement as they want. However, for those who prefer to invest in a fund we now have an alternative that allows them to invest in our core portfolio in a simple and accessible way.

World Stars Global Equity Strategy

Our World Stars Global Equity Strategy continued its positive trajectory in March, closing the month up 4.2% in US dollar terms, outperforming global markets. This brings the year-to-date performance to 12.4%.

Performance was supported by our holdings across the board. It was led by British American Tobacco, which rebounded nicely as changes at the FDA's helm in the US alleviated some of the worst regulatory concerns. The stock had suffered in recent months on the back of concerns that an aggressive anti-nicotine approach from the US regulator would place one of BAT's key markets at risk. The change in leadership at the FDA has paved the way for a more differentiated approach in regulation and a more progressive volume decline environment for traditional cigarettes in line with historical trends. Leading video game software developer, Activision Blizzard, rebounded strongly as Google launched its new video gaming streaming service, Stadia, widening the addressable market and reducing the dominance of the console makers Microsoft Xbox and Sony PlayStation. At the same time, mobile tower operator American Tower continued its positive trajectory following solid results posted in late February. The market is increasingly recognising that the company will be a key beneficiary of the next generation 5G rollout in the US as wireless carriers look to improve their networks.

On the weaker side, EssilorLuxottica, the global leader in lenses and frames, came under pressure as news emerged of issues in the boardroom. Conflict between the founder of legacy Luxottica, Leonardo del Vecchio, and Essilor's former CEO and vice chairman of the combined group, Hubert Sagnieres, grabbed headlines and resulted in a fall in the share price towards the end of the month. Although the dispute is likely to drag on, we do not believe at this stage it is likely to impact the actual operational performance of the combined company or impede the realisation of the targeted synergies, though we will continue to monitor the situation closely.

Multi-Asset Income Strategy

The Multi-Asset Income Strategy saw another positive performance for the month of March, closing the month with an overall return of 0.2% in US Dollar terms. It is now up 5.6% year-to-date.

The returns were clearly driven by the continued strong recovery in equities from the end of last year, up 1.4% (up 14.0% since the start of the year). The credit portfolio lost some of its recent gains following its strong performance with a slightly negative 0.4% contribution for

the month, although it remains 4.1% up for the year. Non-correlated funds finished flat in March, up 0.9% for the year.

The weakness in the credit portfolio was mostly driven by turbulence in some of the Turkish holdings ahead of the local elections and renewed speculation on the Lira. However, strong performances from the energy and mining holdings of YPF, Tullow, Stillwater and Petra Diamonds, as well as recovery from Pemex and Kaltex provided an offset.

The strategy saw some slight adjustments with the addition of two equity holdings, Becton Dickinson and Siemens Healthineers, both leading global medical equipment providers. We also added to an existing bond position in YPF Sociedad, the leading Argentinian energy company, taking advantage of a very attractive current yield in the region of 9%.

Trade tensions between the US and China and the EU still remain major concerns for investors. The US Federal Reserve took on a more dovish tone regarding future interest rate rises and the management of its balance sheet. This change in tone put pressure on US Treasuries' long-term yields, prompting a short-lived inversion of the yield curve (long term yields lower than short term yields). An inverted yield curve is commonly viewed as a harbinger of recession. The European Central Bank added to the dovish tone chorus by raising the prospect of more quantitative easing if the softer economic environment in the EU warranted it.

Although there have been signs of slower economic growth in China and Europe, the US economy and most emerging markets' economies are still growing at a reasonable pace. More supportive central banks policies are positive for both economic growth and corporate earnings. Lower than expected interest rates are also supportive for valuations.

We are very confident that our portfolio is well positioned to generate solid cash flow and performance on a medium- and long-term basis. There is always the possibility of an increase in volatility in the short term as a result of profit taking or adverse political developments. However, our attention remains focused on the quality of our holdings and their fundamentals over the long term.

Emerging Market Bond Strategy

Our Emerging Market Bond Strategy ended March up 0.6%, bringing the year-to-date performance to 5.7%, both in US dollar terms. Following the compression of credit spreads and new issue risk premia, we feel that it is unlikely that we will see a repeat of the strong performance in the first quarter and we should not expect much more than earnings carry going forward.

US Treasury yields fell to levels not seen since 2017 and as we stated earlier, the front end of the yield curve (up to five years) inverted. We believe that this is more a reflection of a change in sentiment of weaker global growth and geopolitical uncertainty, combined with a dovish Fed, than a sign that the US economy is moving into a downturn.

In the context of growth, however low, and accommodating central banks, investors feel that credit markets are in a "goldilocks" scenario, which is the environment we have had so far this year.

Our top performers this month were the laggards of last month: both Kaltex and Pemex were up 10.3% and 6.7%, buoyed by investors fishing for bargains. In the case of Pemex, investors are comforted by the forthcoming announcement regarding the use of the sovereign stabilisation fund to recapitalise the company. We will also watch if proper measures to address the structural problems in the company are announced at the same time.

Last month we were active on the strategy, reducing our Brazil allocation as we thought that credits were fully priced. Investors are now waiting for President Bolsonaro to deliver on reforms. We tendered our Petrobras position and sold Rumo. We bought the Koc new issue, which we thought came at attractive levels, being the largest Turkish conglomerate with a proven track record of financial discipline. Turkey will remain volatile, as we most recently experienced through the municipal elections. This is when we want to be nimble and take positions in flagship corporates. We also took a position in an Indian renewable energy producer, for diversification purposes. Overall, our cash position remains the same at 19%.

As we have said, despite the uncertainties we are heartened by the strong start of the year both in terms of the global economy, especially in the US, and markets, which have recovered most if not all of the ground they lost at the end of last year. It confirms our conviction to look through the volatility and to remain focused on the fundamentals to allow us to make the right decisions for the long-term.

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