Commentary

'QUE CUANDRO NOS VAYA MAL, NOS VAYA COMO AHORA'

'If we have bad times let them be like today's' – This Mexican saying reflects our thoughts as we look back on the first half of the year, with its strong performance across equities, debt and other assets despite the geopolitical and macroeconomic uncertainties we face across the globe.

We are troubled by these uncertainties, from the epochal shift in global power from a US-dominated world to one in which China and other growing economies take their place with their distinct histories and interest, to the increasing realization of the impact unfettered climate change will have on our environment and our prospects, and to the worrying consequences of real and perceived inequality that give rise to the feeling that people face a zero sum game.

Yet as Harvard cognitive scientist and cultural observer Steven Pinker writes in Enlightenment Now, his brilliant argument for a positive view of economic and social progress, by almost any metric we are living in the best time to be alive, and we have the means to shape our destinies and confront the challenges we face.

Our thoughts echo what we wrote last month, that we may overestimate the effect of new technologies in the short run but underestimate the effect in the long run. Unfortunately, we had a technical issue with sending out our comment last month so you may not have received it. We wrote about one of the new technologies that has enormous potential, blockchain, and Facebook's announcement that it was launching Libra, a digital currency conceived as a stable coin, backed by real assets, and in partnership with other technology and payments companies. We think that digital currencies have tremendous disruptive potential and that despite the regulatory and other issues that have to be resolved, we have had a glimpse of a technological change that has enormous potential and that we should not underestimate even if we cannot know today how and when it is likely to be applied. You can read the full comment on our website or by clicking on the link here.

We invest for the long-term as you know, but the fact that we were unable to send our monthly performance update to many of our readers allows us to make an interesting observation about short term performance. What was a poor month for our World Stars equity portfolio in May (down -4.5% in US Dollars) was followed by a stronger month in June (+6.4%) taking it to a new high for the year. We could not actually say what changed between the two months. It may have been the decline in trade tensions between the US and China or the more accommodative language by the US Federal Reserve and the ECB. What we can say is that it is further evidence that the best months come right after the worst ones and that it reinforces the point that market timing is a futile exercise that is likely to lose far more money than it gains.

Thinking about broad changes driven by technology, demographics, climate change and other forces is critical to understanding the impact they may have on our societies and economies. It is also essential to identifying the risks and opportunities they hold for our investments. In addition to blockchain, we have already written about the disruptive potential of digital healthcare, autonomous cars and the internet of things. Because of the issue last month, we are resending you Katerina Kosmopoulou's insight in which she writes about 'Smart Cities' and concludes that they are already here—another change whose short term impact we may have overestimated but whose long-term impact we are only beginning to understand. You can read it by following the link here or by clicking on the attachment.

If we have bad times, let them be like today's… As we wrote last month, we think that overall businesses are doing well and are getting on with it despite the headlines. We continue to think that we are in a normal mid-cycle period where growth is slowing after a period of high growth and where companies, central banks, and other players are adapting what they do accordingly. It is in no-one's interest to unsettle the economy and in particular we do not see how it can be a surprise that the Fed and the ECB are data driven and that as they see growth and inflation slow they will slow the pace of rate rises as well.

The second half of the year is likely to be no less volatile than the first and we will hear from companies about their results for the first half of the year and for now, the outlook for the second half. Many if not most of our companies are positive about their businesses so we look at any major volatility as an opportunity.

World Stars Global Equities Portfolio

Our global equities World Stars strategy closed June up +6.4% in US dollar terms, rebounding from recent market volatility and bringing year-to-date performance to +18.0%.

Performance during June was led by a sharp rebound in our more economically sensitive holdings, including oil services leader Schlumberger, the online travel platform Booking Holdings, and leading Industrials player Eaton. The share prices of these companies had come under pressure in previous months amidst deepening trade tensions between China and the US, as the US administration threatened to impose higher tariffs on Chinese goods and placed restrictions on trading with telecommunications equipment and smartphone provider, Huawai. We thought that these concerns were fully reflected in stock valuations, a view that was vindicated in June as these names rebounded amidst a more conciliatory tone between the US and China—echoed in the G20 summit—and the signalling by both the US Federal Reserve and the ECB that they are ready to provide monetary policy support as needed.

Looking at performance for the first six months of the year, we have seen broad-based strength across our holdings.

Performance was led by Facebook amidst strong ongoing operating performance, an increasing international user base, robust advertising trends and clear proactivity by the management in addressing privacy and political intervention concerns. Meanwhile, the recently announced initiative in the cryptocurrency space only points to the significant array of still unexplored opportunities at the company's doorstep. Within the payments network space, Mastercard continued its upward trajectory, underpinned by strong momentum in both its domestic US and international businesses on solid consumer spending trends and the structural shift to a cash-less economy. At the same time, the company's acquisition of Vyze, a player in the 'buy now, pay later' solutions space, reflected its ongoing investment in new payment ecosystems.

Within the consumer companies, LVMH, the global leader in luxury goods, posted double-digit organic growth led by Asia and the US and ongoing momentum in its fashion and leather and champagne and cognac businesses. Nestlé, the global food and nutrition company, illustrated its strengthening momentum with solid delivery in key product categories including pet care, coffee, infant nutrition and medical nutrition, whilst continuing to optimise its portfolio with the sale of non-strategic assets like its Nestlé Skin Health business. Finally within health care, life sciences leader ThermoFisher was supported by consistent high single-digit organic growth and continuing gains in market share. Thermo's announced acquisition of Brammer Bio, a leading CDMO franchise for gene/cell therapy, was yet another example of the company's targeted capital deployment strategy and the opportunities it can seize because of the strength of its balance sheet.

As we take stock of our portfolio's performance during the first half, we are encouraged to see the breadth across sectors and themes that drove our positive returns. It reflects the strength of the underlying business models, the abundance of growth opportunities our companies have because of the markets they are in and the leadership positions they have within them all of which give them the ability to thrive despite geopolitical and macroeconomic uncertainty.

As you know we offer our World Stars global equity strategy as separate accounts or as a UCITS fund. You can find the factsheets and other information on the fund on our website or click on the link here.

Multi-Asset Income Portfolio

Following a volatile month in May, June's performance was strong across all asset classes, with an overall return of 3.3% in US Dollar terms over the month, bringing the portfolio up 9.2% over the first half of the year.

While equities recovered from the weak spell the previous month with a positive return of 7.2% (leaving them up 20.8% since the start of the year), the credit portfolio also continued its steady upward performance, generating a positive 2.8% contribution for the month. It is now up 7.9% since the start of the year. Non-correlated income funds were up 0.2% for the month of June, and are up 2.6% for the year as a result.

Global asset classes, with a few exceptions, have been supported by renewed dovish talks by central bankers and the strong possibility of cuts in interest rates over the near term to support a global economy that is showing signs of slowing down. As a result, fixed income assets witnessed record levels of inflows.

During the course of the first six months we took profits in some of the Turkish corporate bonds we purchased during last summer's rout, whose expected return had reduced markedly because of their good performance. Some of the proceeds have been reinvested into higher yielding names such as Chesapeake, Grupo Posadas and TV Azteca, all yielding in excess of 7.5%.

Similarly, for equities we added a number of 'med-tech' names to the portfolios consolidating our barbell approach for the rest of the year.

Markets have been unsettled by the escalation in trade and geopolitical tensions and their potential impact on global economic growth. The current spat between the US and Iran could affect oil prices and general stability in the Middle East, with a possible ripple effect on the level of volatility in markets, especially during the low liquidity summer months.

We continue to focus on investment opportunities which are well positioned to generate strong earnings growth for equities, cashflow, deleveraging benefits, and improving credit ratings for bonds which we hold to maturity.

At the half year mark, the portfolio has so far produced a 2.4% cash yield and is well on track to achieve our goal for the year while, combined with our non-correlated funds, keeping volatility contained.

Emerging Markets Bond Portfolio

The sharp rally in US treasuries which began in May when the yield on 5-year government bonds crossed the 2% mark for the first time since September 2017 continued into June, resulting in a 50 basis points decline in the US 5 year and the 10 year yields, down to 1.77% and 2.01% respectively.

Investors reacted positively to this benign rate environment, fuelling inflows into the Emerging Markets asset class. A positive outcome from the G20 summer, with a resumption of trade talks between the US and China, sparked another leg in the rally, with a real chase for yields resulting in strong flows into Turkish, Argentine and Ukrainian credits.

As a result, our Emerging Market bond portfolio ended June up a solid +2.4%, pushing the half-year performance to +9% in US Dollar terms. This has been the strongest first half since the global financial crisis. The main drivers of performance have been strong US treasury returns (+4.3% for 5 year US treasury YTD) and strong credit performance across countries and assets.

June's performance was led by Turkish names in the portfolio, boosted by the results of the Istanbul elections which confirmed victory for the opposition party candidate. Markets cheered the possibility of political change but the subsequent dismissal of Turkey's Central Bank Governor on 6th July was a reminder of the challenges facing Turkey and its economy.

Another very strong performer in June was Ukrainian poultry company MHP, up +5.9%. MHP has been benefiting from investors' search for sound credits yielding more than 6%. The company released a solid set of results for the first quarter, with strong volumes, stable pricing and a positive outlook.

Argentine oil company YPF declined as Cristina Kirchner presented herself as a credible candidate for the presidential elections. The bonds have rallied 4.1% during the month of June and bonds are now up 12.1% year-to-date. Volatility is likely to persist in Argentina until the first round of the presidential elections on 27th October, given the difficult macroeconomic situation. The next important date is 11th August when the primary elections, known as PASO, will provide a first indication of voters' intentions.

In terms of activity, we sold our position in Marfrig, the Brazilian food processing company, taking advantage of the bounce in prices on the back of the tender offer. As a result, we are now running a 15% cash position, content to keep it at this level so we are nimble during the summer months, when liquidity typically dries up and volatility can offer opportunities to get back into the market at attractive entry points. We do not want to chase the rally at this point and are comfortable with the allocation and positioning of our portfolio in solid credits.

As we said last month, we continue to see a constructive outlook for the major economies, companies and markets. However, despite the ongoing strong performance of our portfolios and markets we do not think we have seen a 'melt up' yet. Stock market valuations are at the higher end of periodic ranges but in most cases still consistent with potential returns given prospects for growth of sales and cash flows. Fixed income is a different story with yields back to record lows. In this kind of environment real assets that can generate returns and offset inflation are at a premium. The 'hunt' for those assets will be the cause of any melt up in stock markets if we see one in the future. Political uncertainty continues unabated, so we are braced for volatility, which will hopefully provide opportunities to buy some of our favourite assets at lower prices.