J. STERN & CO.

The Value of Long-Term investing

Insight

THE CLUE IS IN THE NAME: *Quality, Sustainability and Long-Term Value*

When Maurice Stern had to leave Paris with his family to escape from the German occupation and came to New York, he had to decide how to invest the capital he had in the United States. He faced the loss of the family's bank, their houses and their other assets in France and the possibility of never being able to return. He invested in the stocks of great companies based on principles that still guide us today.

J. Stern & Co. represents the third generation of the family to invest in quality and value for the long-term. Quality to us is a company that has a strong and sustainable competitive position in a good and growing industry, with a management a track record of value creation and a balance sheet so strong that the company can weather any adversity. Value is being able to buy that company at a price that allows us to generate 8-10% or more over the long-term.

The challenge for us as long-term investors is how to build on the experience of the past and to adapt our approach to the opportunities and challenges we face. We realized that the digital transformation of our societies and our economies has only just begun and that there are digital platforms that have great prospects. That is how we bought stocks like Amazon, Alphabet or Adobe and added them to our portfolios. We continue to see significant upside and had the opportunity to express our views in a number of outlets when Alphabet crossed the threshold of becoming a $1 trillion company. We think that Alphabet is on its way to becoming a $2 trillion company and a strong future dividend payer when it changes its capital allocation policy and starts returning part of the cash it makes to shareholders.

Today we are facing a similar moment when we have to adapt what we do. Climate change and the existential challenges it poses has been one of the primary drivers of an increasing awareness of the impact environmental, social and governance (ESG) issues can have on companies, their operating and financial performance, and their prospects for value generation.

The clue is in the name, as it were. In order to have a sustainable competitive advantage, companies have to operate in a sustainable way. This has always been our approach, but over the last few years we have seen issues of sustainability, transparency and accountability grow in importance, with the broader investment community being asked by both clients and other stakeholders to better understand what outcomes companies are delivering for broader society.

The United Nations have worked to establish global sustainable development goals (UNSDG) that provide a blueprint to achieve a better and more sustainable future for all. We believe that the discourse about sustainable investing will increasingly focus on the UNSDG and we will be called on to answer the challenge they pose: What are companies and investors doing to achieve a better and more sustainable future for all?

We have worked over the past six months to fully integrate our investment process in a rigorous, transparent and repeatable way. We have signed up for the UN

J. Stern & Co
4 Carlton Gardens
London SW1Y 5AA
United Kingdom

Tel: +44 20 3478 1800
Fax: +44 20 3478 1799
info@jsternco.com
www.jsternco.com

Principles of Responsible Investing (UNPRI) and similar organizations. Our insight this month provides our *Roadmap to Sustainable Investing* and explains the background, methodology and criteria we use to identify and analyse issues and examples of companies in which we are invested and with which we have engaged to address them. Please read more about approach it by following the link here or by clicking on the attachment.

Our approach is grounded in the conviction that sustainable long-term returns can best be achieved by investing in sustainable companies that have the ability to deliver long-term growth and innovation. It does not surprise us that most if not all of the companies in our World Stars strategy rank highly in terms of their ESG ratings with different ratings providers and in our own framework. We think that Maurice Stern's principles are as relevant today as they were when he first started investing and that he would believe as strongly as we do that we should keep adapting to the opportunities and challenges we see and to make the most of them by investing in companies that have quality and value for the long-term.

We shared our 2020 outlook with you in our December insight. As you know, we have been positive about markets and about the stocks in our portfolio. Last year, our World Stars global equity strategy was up 29.1% in US dollars, keeping up with the MSCI World while investing in a diversified number of high quality companies, strongly outperforming it over the past three and five years, and delivering 11% total return per year after fees since we started the portfolio in 2012. Yet despite this strong performance, growth has been strong and valuations of our stocks are still attractive, in some cases even cheap. We are still positive about the global economy, our stocks and markets more broadly because we do not see signs of excess capacity, accelerating wage increases or rapidly increasing inflation. As we write, companies are reporting their results for the past year and their outlook for the current one. So far they have been positive and even in those cases where the market reacts poorly because companies have higher costs because they invest in growing or strengthening their businesses, as many of the digital platforms have, we believe these are investments that will generate positive returns in the long-term.

This year will be one of the great political, social and economic uncertainty, with the US elections and impeachment proceedings through the course of the year, Brexit and the difficulty of negotiating trade agreements with the US and the European Union by December, and the current coronavirus, which is affecting a greater number of people but will hopefully resolve itself through the significant efforts being made to contain the disease and to treat those affected. The measures will have a significant impact on Chinese GDP growth and consumption, which should lead to opportunities to buy some of the companies that will be affected at lower prices and to benefit from the inevitable rebound in growth and consumption the Chinese government will stimulate to reduce the impact the current lockdown will have. Given the importance that the US and Chinese governments have to place on delivering economic growth and prosperity, their interests should be aligned throughout the year. We will be vigilant as always but think there is still significant upside in the companies we own.

World Stars Global Equities

During December our World Stars global equities strategy continued its positive trajectory, closing the month up 3.2% and bringing performance for 2019 to an exceptional 29.1%, both in US dollars.

Performance during December was broad based, with positive contributions across most if not all themes and sectors. Of note, creative software provider *Adobe* had a very strong year with quarterly results ahead of street expectations. Positive investor interest was fuelled by the Adobe MAX conference that we had the opportunity to attend in Los Angeles last November, and that allowed us to see first hand a number of exciting new product launches. The Digital Media segment performed particularly well due to the ongoing strength in Acrobat and robust customer acquisition.

Gaming software developer *Activision Blizzard* benefited from momentum into the holiday season and an exciting pipeline of new games. The company's flagship franchise, Call of Duty Modern Warfare, continued to grow following its launch in October, whilst the mobile version of Call of Duty also had a very good start. We expect console titles on mobile to be a key growth area for the company going forward.

B*ooking Holdings*, the leading online travel platform, recovered strongly as it bounced back from the recent newsflow within the wider travel industry. As we noted last month, Booking's own results have continued to come in strongly with momentum in room night growth and earnings growth ahead of street expectations. Although sentiment in the sector remains poor, Booking continues to be the leader in a secular growth market whilst trading at a discount to its historical levels.

On the weaker side was spirits producer, *Pernod Ricard,* on the back of the company's decision to reduce inventory at its US wholesaler network whilst tariff concerns weighed on the broader sector. At the same time, what was likely year-end sector rotation led some investors to take profits on some of the higher valued consumer staples names, shifting the proceeds to more value oriented names in the short term.

For the year as a whole, performance was equally broad based across themes and sectors. *LVMH* continued to lead the luxury sector, with no signs of slowdown in revenue growth especially in China, whilst its acquisition of legendary jewellery franchise, *Tiffany*, consolidated its leadership position in the sector. *Mastercard* continued to benefit from the structural shift to a cashless society and healthy consumer spending levels. *Facebook* benefited from solid advertising momentum and retreating concerns around its ability to manage increased regulatory scrutiny. *Adobe* remained the undisputed leader in creative software with the recent Adobe MAX conference highlighting the multiple growth levers for the company ahead. Life sciences leader *ThermoFisher* benefitted from its strategy of sector consolidation, market share gains and operational efficiencies. Industrial companies *United Technologies* and *Eaton* continued to drive shareholder value by further optimising their business mix and corporate structures.

Multi-Asset Income

Last year ended on a strong note with our income driven strategy up 2.1% in US dollar terms, taking the year-to-date performance to 12.6%, or 7% annualised net return since inception. All asset classes ended the year on a strong note but once again equities were the main driver with a good performance of up 3.5% on the month (a remarkable +35.3% for the whole year). The fixed income and non-correlated funds were up 3% (up 6.6% for the year) and 0.2% (up 5.5% for 2019, respectively, with non-correlated funds likely underreporting performance due to the lag effect in the reporting of some of the funds).

The cash generation was strong as well, with a 4.2% cash yield generated for the year, delivering on one of the key objectives of the strategy.

Throughout last year investors were reading too much into the inverted yield curve. Although the global world economy was slowing down, our central assumption based on what we could see at the corporate level was that the US economy would not fall into recession. We believed that with the support of all major central banks the global economy would first stabilize and then potentially reaccelerate towards the end of the year.

Risk assets benefited from factual evidence that the economic environment was improving and the improving news flow on the US-China trade war.

Last month saw *AA* bond prices sharply improving, following the dramatic Conservative party victory at the UK general election and the initial phase of the Brexit process. We expect further positive momentum, although volatility may increase as the negotiations between the UK and the EU get closer to the deadline of 31 December 2020.

Looking forward the income strategy's objective is firmly focused on generating a solid cash yield with low relative volatility. Following an exceptional year, we remain constructive and feel that the environment could surprise to the upside. This in turn would also mean higher interest rates, which could prove somewhat of a headwind for the markets.

However, both our equities and corporate bonds will benefit from improving fundamentals and our Multi-Asset Income Strategy is well suited for these markets.

Emerging Markets Bonds

Our Emerging Market Bond strategy rallied 0.9% in December, bringing the year-to-date performance to 10.6%. Looking at the breakdown of 2019 performance, 6.1% was generated by income and 4.5% by capital appreciation, as a result of a compression in US Treasury yields and tightening of Emerging Market credit spreads. Performance in 2019 was helped by the persistence of a 'goldilocks' scenario.

Sustained economic growth, supportive central banks and the completion of the US-China first phase deal was conducive to strong risk appetite.

In December, Argentine oil company *YPF* was up 10.5% (17.6% over the past two months) as investors appreciated the likelihood that the company itself will remain current on servicing its debt given its dependence on foreign investors for the development of the Vaca Muerta formation despite the imminent restructuring of over $100 billion in Argentine sovereign debt. Mexican media company *TV Azteca* was up 9.4% in the month, nearly offsetting all of November's sharp decline. The political and economic environment in Mexico continues to be challenging and investor confidence in government policies is deteriorating, with feeble growth and lacklustre investment. However, we see opportunity in selected corporates where both the carry and the risk/reward are attractive. *TV Azteca* is one of those.

Tullow Oil and *Petra Diamonds* declined as a result of weak operating performance and poor technicals. Investors will need to have better visibility about both the companies' future profitability and liquidity. However, we believe that in both situations the bonds have been oversold.

For 2020, we are cautious about Turkey and Brazil, both of which seem to be priced to perfection. We will be looking to increase our allocations by investing in flagship names if a correction occurs. We remain overweight in the energy sector despite our conservative view on oil prices with a focus being on high margin and healthy cash generative companies.

Our approach remains the same. We look to invest in companies that have strong business models and solid capital structures, operate in sectors able to benefit from economic growth, have managements committed to financial discipline and present low refinancing risks. By investing in these kinds of companies, we can sustain a certain level of price volatility, take advantage of opportunities and capture income from coupons.

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