Commentary

RESULTS, RESILIENCE, SCIENCE AND INNOVATION

Investing is all about the fundamentals. Markets and our portfolios have been resilient in the face of the economic dislocation we have seen due to the Covid-19 pandemic, warranting our conviction in our approach of investing in quality and value for the long-term.

It has been six months of unprecedented economic and social dislocation. Despite the positive signs, we will have to see how economies and companies manage the next 12-18 months as we see the full impact of the physical distancing measures we have had to put in place to combat the pandemic and as fiscal and monetary measures are scaled back as they recover.

The pandemic has accelerated many of the changes and disruptions we have seen over the past decade. Our definition of quality is forward-looking, and many of the companies we invest in are direct beneficiaries and contributors of the changes as they provide goods and services that help economies and people to function and to innovate in the effort to overcome the challenges.

Several of our companies like the digital platforms and health care businesses have reported record results and have upgraded their outlook. Some like Thermo Fisher and Medtronic have used their balance sheet strength to make opportunistic acquisitions. Others that have been impacted by the inability to provide their goods and services due to the measures are providing indications of resurgent demand in areas where their businesses have been able to reopen.

At the same time the unprecedented global coordination of efforts to develop therapies and vaccines against the virus that causes Covid-19 are beginning to yield results. Global pandemics have occurred for millennia. They may have been slower to spread as they had to travel by caravan or galleon, but they were devastating in impact and casualties. The most recent virus may have spread faster because of our greater global linkages, transport and supply chains. But the global response has been faster too and the impact and casualties greatly helped by our greater understanding of health and science. That is why we believe that the global cooperation of scientists and universities is an example of a positive impact of globalization that we should celebrate.

Zhixin Shu, who leads our research and analysis in healthcare and life sciences, has written an important insight on the significant progress that is being made in the development of vaccines to fight the virus that causes Covid-19. It incorporates the most recent results of the leading vaccine candidates from Pfizer/BioNTech, Moderna and AstraZeneca/Oxford published today. The mRNA vaccine candidates of BioNTech and Moderna have shown good results in Phase I trials and are now heading to Phase II trials, with results expected in a matter of months. The trials will show if the positive results are replicated in wider populations, including critical older and more vulnerable populations, and if there are instances of greater toxicity or side effects.

We are cautiously optimistic that this innovation could lead to vaccines being widely available as early as the end of this year, which would be a triumph of science and innovation. As Zhixin argues, it is also possible that these initial vaccines based on the flexible newer platforms that allow for such a rapid development need to be part of a combination therapy

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that includes therapeutics as well as other vaccines based on more traditional vaccine platforms that require more time for drug development and trials, but also may have longer lasting effects. You can read the insight by following the link here or by clicking on the attachment.

Risks abound, but as we look ahead to the next 12 to 18 months, with all their uncertainties around the progression of the disease, a second wave as the Northern hemisphere enters the winter season, the possibility of greater and longer lasting recession as the impacts of the measures continue on employment, consumption and companies, and the significant political events taking place, not least the US election and the actual exit of the UK from the European Union, we have to keep asking ourselves about the risk and reward of our investment approach.

We have had a number of comments about the quote from our friend Max Warburg, with which we led our comments with last month: "There is no such thing as a rich pessimist". We have said throughout that we are optimistic because we see little point in being anything else. As long-term investors, given the resilience of our economies and of markets, the results of many of the companies and their prospects for ongoing performance in the case of some and recovery in others, and now the possibility of progress if not success in the development of vaccines to combat the pandemic, we can ask the question a different way: With so much evidence pointing to our ability to overcome the effects of the pandemic in a reasonable time frame, what is the point of being pessimistic?

We are deeply saddened to report the passing of David Reid Scott, who was a senior adviser to our firm. David was a leading figure in investment banking and asset management. He was also the long-term chair of the Eton College investment committee, where he was instrumental in helping to grow the endowment to its current scale. David lost his valiant struggle against the effects of a devastating accident he had last year. We greatly appreciated his contribution and will miss his friendship and counsel.

World Stars Global Equities

Our World Stars strategy performed strongly in June, closing up 2.4% in US dollar terms. This results brought performance year to date to 1.6%. Our performance continues to be well ahead of both the MSCI World and the S&P 500 for the month and the year.

Performance was broad based but led by our digital holdings. *Amazon* has continued to lead the portfolio with the company increasingly broadening its competitive moat versus its bricks and mortar competitors. In fact, it is becoming more and more evident that consumers who shifted their shopping online during the pandemic are likely to continue to do so given the ease and benefits, causing a permanent shift in the retailing landscape, with the closure of some traditional high street outlets further entrenching this dynamic.

Creative software and online marketing solutions player *Adobe* also performed well after it reported another strong set of earnings. With more businesses shifting their proposition online during the pandemic, the company benefited from increased engagement with its products. At the same time the company restructured its digital experience business, further focusing resources towards higher revenue and margin opportunities, underpinning its flexible business model.

Within industrials, global leader in specialty chemicals and construction materials player *Sika* performed strongly with the markets recognising that the company stands to benefit from infrastructure investment programs globally. With St Gobain exiting its residual stake in the company in late May, the multi-year legal takeover battle between the companies we helped Sika, its board and management to fight alongside other large investors, has finally come to a complete close, with Sika emerging as a fully independent and strengthened player in the industry.

Also within industrials, leading elevator player *Otis* continued its solid performance following its spin-off from United Technologies, with the stock increasingly closing the valuation gap with its peers, and with the market recognising the multiple revenue and cost levers at the company's disposal as an independent entity.

Finally, leading cosmetics and personal products player *L'Oréal* performed strongly as the management provided a confident update to the market, highlighting the rebound back to normalised demand levels in the key Chinese market. It also flagged the resilience of key categories like skin care, while the pandemic has seen it reap the rewards from its significant long-term investments in digital platforms and advertising.

On the weaker side during the month were some of our medical devices names, including *Alcon* and *Medtronic*. The industry continues to face uncertainty around the pace of resumption in normal operating activity in hospitals globally following Covid-19. However, we believe that given the largely non-elective nature of the procedures involved the question is one of timing rather than ultimate demand and remain confident in the recovery.

Multi-Asset Income

Following our strong performance in May, June saw a further recovery across all asset classes. Performance was up 1.7% in US dollar terms, which still left the portfolio marginally down 1.6% for the first six months of the year due to volatility in the credit markets. What a first half it has been!

The credit portfolio led the positive performance with a 2.4% contribution for the month (now down 14.4% since the start of the year) with equities generating a positive 1.7% return over the same period and further consolidating their positive performance, having risen 4.7% since the start of the year. The non-correlated funds were up 0.5% , more in line with the low volatility we have been used to, and are now flat for the year.

Global asset classes, with a few exceptions, have been supported by the end of lockdown in many countries globally, the strength of the economic rebound in those economies, and surprisingly strong job creations in the USA. More support from central banks and most governments, including additional measures disclosed almost on a daily basis, have also been a key factor. As a result, most risk assets have seen strong inflows, especially fixed income.

Fixed income performed well despite record amounts of new issues in both high grade and high yield debt. As predicted, credit spreads further tightened despite the expected increase in default rates. A strong recovery in oil prices brought more support to the high yield space globally.

Looking towards the second half of the year, there are a number of possible risks. The key uncertainties still include the Covid-19 pandemic and the worrying signs that it is not under control in the USA and Latin America, which is causing concerns about possible new lockdowns and a flattening economic recovery.

We believe that our portfolio is well positioned for such an environment. However, having increased our equity exposure during the correction and after the strong bounce back we believe that it is appropriate to reduce it again in favour of fixed income. The latter currently yields close to 8%, with a yield to maturity of 11% for a duration of less than three years.

We have bought new bonds which offer attractive yields with solid business models. The latest examples of this are *Millicom*, a Latin American mobile operator focusing on a number of smaller markets, and *Rumo,* the largest Latin American logistics company, which took advantage of the strong demand for yield to issue a new 2028 bond offering a 5.25% coupon.

We continue to focus on improving the quality of our overall portfolio. At the half year mark the portfolio has so far produced a 1.8% cash yield, slightly lower than our usual target for the first six months, but reflecting our higher equity holding. Our repositioning of fixed income assets will put us well on track to achieve our goal for the year and, combined with our non-correlated funds, should keep volatility contained despite the uncertain environment.

Emerging Market Bonds

As we end the second quarter of 2020, it has been good to see the significant recovery of most markets since the lows of March. Performance has been driven by a combination of factors, including the rebound in oil prices and the ongoing stimulus from central banks. However, the pace of recovery in emerging markets slowed somewhat in June, as investors became more cautious of rising infection rates in many EM countries such as Brazil, Mexico and India. Despite this, our emerging market debt portfolio returned 2.3% in June, taking the year to date performance to -8.7%.

Brent prices continued their climb back above $40 per barrel, gaining 16% during the month. Our oil credits leading the performance for the third month in a row, with double-digit gains for both *YPF* and *Seplat Petroleum*. *Liquid Telecom*, a communication services provider, and a name that has lagged the broader EM corporate recovery over the last two months, also delivered a strong performance, returning 9.7%. The firm released impressive numbers for its financial year, underpinning our view that data needs are only increasing.

One the weaker side, the Mexican TV broadcaster *TV Azteca* returned -18.9%, as revenues came under pressure because of lower demand for advertising time in Mexico. This decline in demand is due both to the Mexican economy's existing issues and the challenges it faces from Covid-19.

Most emerging market central banks continue to provide extraordinary policy support as they have done over the last few months, cutting rates to historic lows in order to support activity. Despite this, given the low inflationary environment, most EM real rates are still in positive territory. We remain positive going into the second half of 2020, as we believe emerging market debt remains one of the few asset classes in which investors looking for yield should be able to find it.

We hope you continue to be healthy and well and have a good and restful summer. As always we look forward to your questions and comments.

Best regards,

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June 2020