*Commentary*

## THROUGH SCYLLA AND CHARYBDIS

*Much have I suffered, laboured long and hard by now in the waves and wars. Add this to the total —bring the trial on!*

Odysseus in Homer's Odyssey

This year has been an odyssey. We all feel like we have laboured long and hard and have met with many trials. The Covid-19 pandemic and the US elections have been like Scylla and Charybdis, threatening to wreck the global economy and markets. Brexit looms but struggles to make waves among the greater turmoil. Our boat is still in the middle of the storm, the second wave of the pandemic is upon us and the elections are imminent. But the odyssey is coming to an end and we can see the way ahead.

We are at a critical point of the Covid-19 pandemic and its impact. It is clear that is a confounded disease that disproportionally impacts more vulnerable populations but that also has potentially long-term effects on a larger number of people so those who have not had it should avoid it if they can.

At the same it is also clear that the economic, social and human cost of the measures that have had to be adopted to stop its spread have been devasted and that both policy makers and the public have been completely unprepared for the impact of a pandemic like Covid-19, much less a more virulent and deadly one. We think that like with other public health crises, particularly HIV, for which there still is no vaccine, the answer is in a combination of diagnostics, therapeutics and vaccines. We have made great progress on all fronts and it is notable how many of the companies we invest in, in healthcare and life sciences but also in other industries, are directly involved in the fight against the disease.

Most important for the global economy and for markets is a vaccine, and this month Zhixin Shu, our healthcare analyst, provides our latest insights into the status of vaccine development and a roadmap for recovery. It builds on Zhixin's insight we published in July and shows why we believe that we should be months away from having the first mRNA vaccines from Pfizer/BioNTech and Moderna, and should be in a position to achieve a return to normalcy in the second half of next year. The current second wave should already benefit from better diagnostics and therapies that should further reduce the incidence, severity and mortality of the disease. By the second half of next year the initial vaccines should be joined by other more traditional ones that may engender greater public confidence and therefore have broader acceptance.

For now, we have to suffer through the second wave. The difficult decisions to go back into lockdown in many countries will cause great concern. However, governments and central banks have made it clear that they will provide the support necessary to keep our economies going through any fiscal and monetary means necessary. We have said that it is inconceivable to us that governments in the US, China, the UK or the rest of Europe would risk public unrest given the political and economic uncertainty and we think that will be as true before the US elections and Brexit as afterwards.

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Which brings us from Scylla to Charybdis. This time next month the US elections will be over. We all follow the polls but the polarisation and acrimony of the political discourse mean that it is impossible to predict how people will vote compared to what they say before, or how the pandemic and increase in votes by mail will impact the outcome and the timing of the election. We hope that all sides will be responsible, that the US electoral system will be up to the challenge, that there is a decisive outcome and that it will be accepted by the winners and the losers. The US economy and markets have done well under Republican and Democratic administrations and we see no reason to be worried about either outcome.

What does worry us is the potential for risk and volatility if the outcome is not clear or if one of the parties does not accept it. There could be legal battles as in 2000 but there is also the prospect of violence and bloodshed. There is also the possibility that an outgoing US president and Senate could us the time between the elections and the inauguration to of a new president and Congress to take actions that could have adverse impacts on global political and economic stability. These are real risks, but we have great confidence in the US institutions and hope that all sides will see the enormity of this risk and act accordingly.

Through these trials and tribulations our investments have stood the test. Our positions in global leaders that have quality and value have been resilient. The global digital and tech companies have benefitted from the changes and disruptions that have been accelerated by the pandemic. The healthcare and life sciences companies have contributed to fighting the disease and are poised to perform as elective surgeries come back in hospitals in the US and Europe. The consumer companies have continued to provide food, drink, ingredients and other products and where they have been impacted because discretionary consumption has been interrupted by the lack of hospitality and travel, the underlying demand is strong and should come back as soon as restrictions are lifted. All of them have the balance sheets they need to weather the storm and to take advantage of opportunities as many of them do and all of them are at valuations that are attractive for long-term investors like ourselves. That is why we continue to be confident in our approach and constructive about our companies and their prospects for value generations as we get through the current turmoil.

*World Stars Global Equities*

September saw a pullback in global equity markets driven by uncertainty over the US election, concerns over a second wave of the pandemic, and a correction in certain large technology stocks after their substantial rise earlier in the year.

Our World Stars strategy was resilient despite its strong performance this year. It was down -3.5% in September but is still up 10.7% year to date (in US dollar terms) continuing to significantly outperform global equity markets.

Performance was led by a recovery in *Diageo*, the owner of iconic spirit brands like Johnnie Walker, Smirnoff and Baileys. Clearly the current pandemic had a significant impact on the company's on-trade (bars, hotels and restaurants) and travel retail business, but in its recent AGM statement Diageo pointed to improving conditions, with strong consumer demand in the off-trade in the key European and US markets. This is in line with our expectations as markets return progressively to normality in the year ahead, despite the volatility around Covid-19.

Also performing strongly within broader consumer products was *Givaudan*, the leading flavours and fragrances business, which continues to benefit from solid growth in sales and

momentum. As a key player in the supply chain for food, beverages, personal care and household products the company has been instrumental in ensuring uninterrupted product availability during the current pandemic. This has entrenched its relationship with customers and consolidated its market position, whilst allowing it to take advantage of accelerated structural trends like health & wellness. At the same time, Givaudan recently presented a compelling five-year strategic plan, highlighting its industry-leading R&D capabilities, as well as its increased focus in adjacent market segments like active beauty, natural ingredients and local customers where it has aggressively been building its presence in recent years, fuelling the company's future growth trajectory.

Within the healthcare, *ThermoFisher*, the global leading life sciences company, continues to benefit from solid momentum on the back of the significant set of revenue opportunities that the current pandemic has presented. It is expecting to realise over $4.5 billion in incremental revenues this year alone from its Covid-19 related offering, including testing equipment and kits, PPE, epidemiology research lab products, vaccine research and production solutions. At the same time, in its recent annual investor day the company highlighted the longer-term opportunities that the pandemic is opening up, including deeper customer relationships and higher investments in healthcare by governments. These will continue to provide tailwinds long after the crisis has abated.

Also, within the healthcare space, *EssilorLuxxotica,* the world leader in optical lenses and glass frames, rebounded strongly. The Covid-19 outbreak has clearly had a significant impact on the company as optical stores were shut during lockdowns. But with stores progressively re-opening, demand has progressively been picking up. At the same time, the crisis acted as a catalyst to accelerate the integration of the two merged entities and the company is on target to deliver expected synergies of €420-600 million.

Within the industrials space, construction chemicals player Sika also continued to perform strongly, driven by the expectation that infrastructure investments globally will continue to benefit the company's construction business. At the same time, its refurbishment-related business remains resilient, both on the residential and commercial side, whilst its aggressive cost focus continues to shield earnings as outlined in its recent capital markets day. Longer term, the company has ample room for further expansion of its market share in the construction chemicals market through cross-selling opportunities, new product introductions, deeper channel penetration and higher content in key large-scale projects.

Despite this solid reading from a broad range of our holdings, performance was held back during the month by profit-taking in some of our digital-related stocks, including *Amazon*, *Facebook* and *Alphabet*. These companies clearly been key beneficiaries of the Covid-19 crisis, with e-commerce, social media and online advertising emerging as critical solutions providers and market share gainers amidst the pandemic. Investors have, in recent weeks, looked to lock in some of these gains. At the same time, there have been concerns surrounding regulatory scrutiny on these companies given their increased market power and penetration. Nonetheless, we continue to see solid revenue momentum ahead, fuelled in the short-term by the key upcoming Thanksgiving and Christmas holidays, and more importantly by the ongoing structural trends they are benefiting from longer term. As our colleague, Giles Tulloch, wrote in our insight last month, although we acknowledge the regulatory risks, we believe that the most likely outcome of the ongoing DOJ and FTC investigations will not be a break-up of these companies, given their strategic importance to the US economy, but rather remedies geared towards managing the scope of activities, protecting consumer data and privacy, and tightening requirements on managing content.

*Multi-Asset Income*

Following a strong month in August investors stepped away from markets concerned and volatility across asset classes increased as expected. Lack of positive developments on the vaccine front, increasing numbers of Covid-19 cases globally and the proximity of the unpredictable US elections triggered a wave of profit taking. The income portfolio gave up some ground, with a -2.5% decline in September in US dollar terms (although it is still up +2.9% since the start of the year).

Global equities were the most volatile asset class last month and our equity portfolio showed a negative return of -3.9%, although it still remains up a strong +14% for the year despite September's drop. Our fixed income portfolio was impacted by the more cautious mood in markets, but to a lesser degree. It fell by -1.3 % in September and is down -10.2% in 2020 year to date. The non-correlated funds were also affected in September, showing a loss of -3.4% which took the performance year-to-date to-+0.7%.

We believe that the sell-off is a phase in what had been an extremely strong recovery in a very difficult financial and economic environment. As we have said, the next few weeks are going to be dominated by the US elections and the possible outcomes. The key for the direction of markets now is how clear the outcome will be. Markets are seemingly discounting a victory for the Democrats as it stands, as well as the prospect for a very substantial fiscal package to support the US economy. If this does end up being the case, it will have a number of repercussions on the expectation for interest rates going forward, and as a result the fixed income market has already started to adjust. With the recent increase in new Covid-19 cases, global economic growth also remains an issue short-term, especially as many furlough programmes are close to being unwound. However, positive developments on the vaccine front and the soon to be released US earnings season should support risks assets.

Our fundamental approach and long-term investment horizon should serve us well in this environment. Our credit portfolio has a yield to maturity of 10% and a current yield of 7%, with a very short duration of just 2.3 years. So far this year the Multi-Asset Income strategy has generated 2.6% cash-on-cash, and we remain constructive for the rest of the year.

*Emerging Market Bonds*

Resurgent positive market sentiment stalled somewhat in September as infection rates spiked in many countries around the world, leading to a -0.3% decline in our Emerging Market Bonds strategy for the month. Despite this, returns for the quarter have been robust at +3.2% for the period. Similar to last month, *Grupo Kaltex* and *TV Azteca* continued their recovery and were the best performers, with returns of +14% and +13.2% respectively. Meanwhile, *PEMEX* and *YPF* sold off during the month as higher beta, oil-exposed credits continued to be volatile at a time when investors are questioning the speed of the economic recovery, and how oil demand will evolve in a potential second lockdown scenario.

Last month we touched on Argentina's latest debt restructuring and their precarious economic situation. In September, the Argentinian Central Bank announced that they were imposing capital controls, effectively limiting access to foreign currency for corporates until March 2021 in an attempt to stem their rapidly depleting hard-currency reserves. The restrictions sparked a broad sell-off across Argentinian assets and presented an opportunity for us to buy *YPF* 2021 bonds in the low 90s, essentially locking in a prospective 30% yield to maturity for what in our view is a high-quality credit with limited refinancing risk.

Turkey, another country which has been under pressure lately, saw its credit rating downgraded to B2 by Moody's, an action that was prompted by the recent deterioration in their external fundamentals, as well as heightened geopolitical risk. We have been cautious about Turkey for some time, and the risk of another balance of payments crisis led to our decision to reduce our overall exposure to the country. We sold our position in *QNB Finansbank*, realising a profit of 10% since buying the bond in April this year.

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