Market Commentary

LINCOLN, CHURCHILL, ZUCKERBERG — DEMOCRACY AND ELECTIONS IN A DIGITAL AGE

“Elections belong to the people. It’s their decision. If they decide to turn their back on the fire and burn their behinds, then they will just have to sit on their blisters”. Abraham Lincoln’s quote, whether he said it or not, is a great reminder that democracy is a messy business. If there was any question this past year has proven it beyond all doubt.

Pandemics such as Covid-19 are easier to handle if there is no need for elections and if people’s civil liberties can be curtailed without having to ask those same people for their vote. Elections like in the US this year would not cost $14 billion if vodka or Moutai-fuelled banquets and party conferences were all it took to select a leader.

“No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of government except for all those other forms that have been tried from time to time”, is an actual quote from Winston Churchill. Democracy and free markets are both necessary conditions for the innovation, progress and prosperity we have achieved.

The outcome of the US elections is a great example of just how messy democracy can be. Victory for Joe Biden and Kamala Harris was significant and historic in terms of the popular vote and decisive, but much narrower in terms of the electoral college. However, it did not lead to a ‘blue sweep’ delivering control of Congress as had appeared likely before the vote.

One of the most important aspects of the US elections, however, is not the balance of power in Washington but a broader impact on democracy and free markets.

Going into the elections, it was said that Mark Zuckerberg could end up deciding the result. It could be argued that has now come true.

This election was a turning point for social media. The 24-hour news cycle has been replaced by the instantaneous tweet or Facebook post. A majority of Americans get their news from the big platforms like Twitter, Facebook and Instagram, so they play a critical role in shaping political discourse and opinions.

With great power comes great responsibility and the platforms have taken important steps to create responsible content policies, to moderate content posted on their platforms, to label posts that contain misinformation, defamation, hate speech or incitement to violence, and to ban accounts that repeatedly violate their policies.

They have accepted the need for change during this election, the biggest, most contested and messiest of the digital age so far. As we have written in our insight on tech regulation in September this year, regulatory scrutiny will increase but these actions will stand them in good stead overall even though there are no easy solutions and not everyone will agree with each action they take.

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As long-term shareholders, it is good to see Facebook, the biggest social media platform of all, proactively improving its content and accountability, and ultimately their own long-term prospects.

The election result, and in particular the prospect that the next occupant of the White House is a pragmatic moderate with decades of political experience and relationships with Democrats and Republicans alike, sets the tone for the next four years in terms of politics and markets.

Given the challenges, investors will welcome a period of more constructive policies and greater predictability. The fact that there has been no blue sweep also means that Biden will have to work with moderate Democrats and Republicans in the Senate to get things done, which will limit the risk of significant changes that could impact the economy or upset markets. With control of the Senate dependent on the outcome of the two run-offs in Georgia, either outcome — an evenly split Senate with a tie-breaker vote for the Democrats by vice president Harris, or a narrow one or two-vote majority for Republicans — will encourage pragmatism and moderation, and will be good for markets.

The vaccine news from Pfizer/BioNTech and Moderna has also been highly positive, The US and Europe are still in the middle of the second wave of Covid-19 and are facing renewed lockdowns with the expected negative impact on economic growth, unemployment and further increases in national debt. The US is showing record increases in cases across the country and the situation is likely to get worse before it gets better next year. As we have written in our insights on the vaccines in July and October of this year, it is clear that mass vaccination will present major logistic challenges for a variety of reasons and will not be widely available until the second half of next year.

It also clear that governments and central banks will do what it takes to support their economies through this period of challenge and distress. The current low and in many cases negative interest rate environment is likely to prevail for a prolonged period of time and forces investors to adjust their expectations of risk and reward from their investments, in particular fixed income investors who no longer can offset the increase in their liabilities through government and investment grade corporate bonds. Our insight this month discusses the reasons for the low and negative rates and the consequences and opportunities we see for investors.

Our investment horizon is longer than a tweet or a Facebook post, and longer than any electoral cycle or two-year pandemic. The good news is not that we have suddenly overcome the divisions and challenges of the past decades. It is that democracy has been resilient and is still the worst form of government apart from all others. It is not that the mRNA vaccines will rid us of Covid-19 and allow us to travel anywhere again by year end. For it is that the virus responds to vaccines at all and that we have the prospect of turning even this calamity into an opportunity by achieving medical breakthroughs in record time and being better prepared for the next, worse outbreak.

We can see how positively the outcome of the US elections, coupled with the news about the effectiveness of both mRNA vaccines has been received by investors. People are worried about melt-downs but it could be the start of a melt-up phase for markets.

With the US and other markets reaching record highs, we expect our healthcare, consumer and industrial stocks to join our digital stocks in leading equities higher as investors can finally

look ahead into next year and beyond with greater certainty, and we will look to take advantage of any volatility in the months to come.

World Stars Global Equities

Our World Stars Global Equities strategy showed its resilience in October as a second wave of Covid-19 cases swept across Europe and the US, with the strategy down -2.7% in US dollar terms, but continuing to outperform global markets. Year-to-date it has maintained a solid absolute performance of +7.7%.

Leading our performance during the month was *Alphabet*, the parent company of Google. Although the US Department of Justice filed a lawsuit against the company on anti-trust grounds, this was more limited in scope than the market had feared. As we had written in our September insight, we believe that the outcome of such regulatory action against the big digital names will be more geared towards placing certain restrictions on future M&A activity and new product development, rather than more radical solutions. A break-up or a significant curtailment of current activities, for example, seems very unlikely given the vital role that these companies play in terms of their importance to the growth and resilience of the US economy.

Also performing strongly within the broader technology space was sensor and connector manufacturer *Amphenol*, which continues to benefit from higher bandwidth demand amidst the current pandemic, reflected in solid growth in its IT & Datacom, Broadband and Industrial businesses. At the same time, the Mobile Devices and Automotive segments showed a strong inflection back to growth as customers re-opened production facilities post the lockdowns during the first half of 2020. The company has been able to gain share amidst the crisis, as clients have looked to those suppliers that have the scale and operational flexibility to quickly flex production to meet sharp variations in demand. It is a long-term beneficiary of the 'electrification of everything' and it is a key consolidator of the sensor and connector industries.

Healthcare and life sciences leader *ThermoFisher* also performed strongly. The company reported 34% organic revenue growth during the third quarter, on the back of over $2 billion in Covid-19 response-related revenues. ThermoFisher has emerged as a key beneficiary of the current pandemic, supplying critical testing and PPE solutions as well as supporting the global effort in therapies and vaccine development research. As we look into 2021, the company is well placed to benefit from the production of vaccines to combat the virus, whilst continuing to support the global healthcare response to the pandemic. Longer term, the company is emerging from the crisis with deeper customer relationships across the healthcare value chain, and a larger installed base of equipment that will drive revenue opportunities well after the pandemic has abated.

Spirits producer *Pernod Ricard* posted better than expected results, benefiting from a return to growth in the key Chinese market as well as strong trends in off-trade demand in the US and Europe as consumers continue to purchase spirits for at-home consumption. At the same time, key trends like premiumisation remain unaffected, as consumers look to treat themselves with higher-end, premium spirits amidst the crisis.

Finally, *Eaton*, the US electrical products and power management solutions leader, maintained its solid momentum. Its electrical businesses continue to benefit from strong demand in key

end markets like residential, data centres and utilities, whist also reaping the benefits of infrastructure stimuli programs globally. Like all our industrial holdings, the company has also swiftly adjusted its cost base, shielding its profitability and cash flow through the crisis. The upcoming sale of the hydraulics business will reinforce the company's already solid balance sheet, further fuelling its ability to close strategic acquisitions or return cash to shareholders.

On the weaker side during the month were global payment networks *Mastercard* and *Visa*. Both companies continue to benefit from the transition to a cashless society and the shift to online retailing, both of which have accelerated as trends during the current pandemic. However, the more muted pace of cross border transactions caused by Covid-19's impact on global travel has impacted temporarily on one of the higher yielding areas of their revenue mix. Nonetheless, given the undisputed structural trends underpinning electronic payments, as outlined above, we see this weakness as a buying opportunity, and we continue to add to positions.

Multi-Asset Income

October was a month of two halves. A promising start to the month, helped by the prospect of an agreement between the Democrats and Republicans in the US for a new large fiscal stimulus package was followed by a pull-back in risk assets after the announcement of new lockdowns in Europe, and the US following the surge of Covid-19 infections and the advent of the highly anticipated US elections.

The Multi-Asset Income strategy was relatively steady, albeit still giving up some ground, with a loss of -1.1% in US dollar terms over the month, but it remains up +1.8% year-to-date.

Equities were more affected by the increased volatility, giving up +2.4% in October (although remaining up +11.3% since the start of the year), whilst the credit allocation was more resilient, with a flat performance over the month, leaving it down -10.3% since the start of the year. The non-correlated funds declined by -0.1% in the month, leaving them down -0.6% for the year.

In this macro-driven environment, portfolio returns were mostly driven by company-specific issues, in particular stronger than expected results for both equities and bonds. *Tullow* was a strong performer following the announcement that the group was close to completing the disposal of its Ugandan assets. The $500 million proceeds of the sale will contribute to deleveraging the balance sheet and support the refinancing of the company's remaining debt.

Looking towards the end of this year, we have confidence in our investments and their potential for performance. The portfolio has generated an income yield close to 3% so far this year, in line with expectations, and the underlying momentum continues to be constructive.

Emerging Markets Bonds

Despite the volatility experienced during the month, both credit markets in general and our Emerging Markets bond strategy were resilient, with our strategy returning +0.1% over the period.

Similar to last month, Grupo Kaltex continued its recovery and was the best performer, with a return of +6% in October. The group reported third quarter results during the month, showing a sequential improvement in the top line as economies gradually reopened. It also continues to benefit from previous cost containment efforts which helped drive EBITDA and a return to positive free cash flow for the first time this year.

YPF, along with other Argentinian corporates, continued to be under pressure, amid investor frustration with the sovereign. Argentina's restructured sovereign bonds have sold off 20-30% across the curve since the restructuring in September, the worst performance for any newly restructured emerging market bonds in the last 20 years. Questions are clearly being raised as to whether the government has a credible long-term plan to return the economy to growth as measures so far have been limited, with efforts to support the currency and protect foreign reserves proving ineffective. We see little positive news coming out of Argentina before mid-November when the government will meet with the IMF to discuss a new deal that could potentially anchor policy expectations.

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