

Monthly Commentary

GETTING BACK TO BUSINESS



Whatever happened to September being the month we all come back to from our various summer exploits to get back to business? The news flow about geopolitical issues has been unrelenting, especially the escalating rhetoric around the Korean peninsula. There have been devastating natural disasters that have affected the Caribbean, the US and Mexico that have dominated the headlines for days but have repercussions that will be felt for years if not for decades. By contrast, after the French elections in May, the Germany elections provided a vote for Angela Merkel and the strong and stable leadership she has provided (albeit with a more complicated political set up).

However, despite heightened market volatility as a result of geopolitical tensions, the impact on markets has been limited. In the spirit of getting back to business for the remainder of the year, we want to provide a short overview of where we think we are.

The global economy remains healthy, underpinning the outlook for our investments. The US economy continues to grow driven by a solid labour market, healthy levels of consumer spending and inflecting growth in industrial activity. In Europe, we are seeing a progressive recovery, driven by Germany and also increasingly France. Importantly in France we are encouraged to see President Macron starting to implement much needed policy initiatives, starting off with labour market reform. Central banks in the US, Europe and less obviously so the UK are seeking in a measured way to adapt their accommodative monetary policies to the improving employment and wage data, leading to curtailment of purchases, reductions in balance sheets and raising of rates. Within emerging markets, China maintains a broadly healthy economic pace, India, the subject of our insight this month, is progressively emerging from the effects of demonetisation and commodity related economies have been stabilising.

The main risk remains geopolitical, with increasing aggression by North Korea, political turmoil in the US and lack of progress in Brexit negotiations. In this environment we believe investing in high quality companies whose resilience is underpinned by the strength of their competitive positioning and which stand to benefit from strong long term secular drivers offers the most robust investment approach. The earnings reported by our companies over the summer have supported our view of the fundamental strength of their businesses and our outlook for the year remains constructive.

This month's insight provides a brief discussion of India and the opportunities we see for several of our investments. We take the view that investing in global companies which have strong businesses in emerging markets like India is a great way to benefit from the potential for progress, prosperity and value generation they offer for the next five, ten and 25 years. Our insight presents an overview of several of our positions that have strong businesses in India and how they are looking to generate value.

Equity portfolios

Our World Stars equity portfolio continued to perform during the past month up 0.4% in US dollar terms after fees. Year to date the portfolio is up 22.3%.

Among the positive contributors, *American Tower* benefited as a perceived safe haven investment at a time of heightened geopolitical tension. At the same time, business momentum remains solid, reflected also in our recent meeting with the management, which underlined the multiple sources of revenue growth as carriers both in the US and internationally deploy network assets to support coverage and capacity as mobile data consumption continues to proliferate. *Thermo Fisher*, the global leader in life sciences, also performed strongly as its end markets across the pharmaceutical, biotechnology, academic and industrial verticals remain solid, and as the company continues to drive sales through new product introductions and share gains.

Linking with our comments on India in our insight this month, Diageo was another highlight that did well as its business is picking up in the US, Europe and Latin America, in line with what we are seeing with the other more global consumer products companies that have been out of favour and represent good value today because of their valuations and dividend yields.

Among the negative contributors on the other hand, *Priceline*, the leading online travel booking network, gave back some of its earlier gains as concerns on the impact of geopolitical tensions weighted on travel related names. The company also indicated that it will be reducing its marketing spend in some areas where it is not realising the returns it would like, which raised some market concerns on short term revenue growth, but which we believe actually underlines the entrenched competitive position of the company and its desire to balance growth and profitability. Notwithstanding these concerns the shares have still risen 27% in 2017 in US\$.

Income-driven portfolios

In an August marked by increased geo-political tensions and low volumes the income-driven strategy produced a steady performance of 0.6% in US dollar terms, and +9.2% since the start of the year. Equities were solid again, up 0.3% on the month with year-to-date performance +22.9%. The fixed income portion of the portfolio contributed positively, up 1.2% for the month and +7% year to date.

Global fixed income markets, with little new issues supplied to investors, were driven by a mix of a flight to safety and more spreads tightening due to investors demand especially in emerging markets.

Cash generation accounted for almost 60% of the monthly return. Issuers' earnings releases generally supported price performances. Of note, our recently added position in Century Link bonds was slightly adversely affected by rumours of delays to the on-going merger. At

7.6% net annualised return since inception in US\$ and with 6.4% volatility, the portfolio has been performing solidly and our current positioning makes us feel comfortable for the rest of the year.

Emerging Market bond portfolios

August was the strongest month year-to-date delivering a 1.2% performance for our emerging market bond portfolio, with all the positions ending in the black. Our Argentinian holdings were up more than 3.5% on the month, following the encouraging results of President Macri's Cambiemos coalition in the primary elections. Colombia Telecom jumped 5.9% after its shareholders, Telefonica and the Colombian Government, announced a substantial recapitalization programme, thus boosting the company's capital structure and curtailing leverage. S&P reacted to the news by upgrading the company's rating by one notch to BB+. We kept our position in the perpetual issue paying an 8.5% coupon and being effectively a 2020 maturity, given the likelihood of the management calling the bond at the first call date.

In the context of emerging market debt trading at historically tight spread levels – the lowest since June 2014 – combined with low benchmark rates, primary markets have been extremely active, including some less-known first time issuers and corporates with small balance sheets. It is hard to predict what could derail this benign environment: could it be a surprising rise in US Treasury yields and a sudden dollar appreciation even though the recent geopolitical risks had no effect? Meanwhile, we stick to our “quality” credo, investing in quality companies within our universe, with conservative debt profile.

Basing our investments on what we can know and analyse has served us well so far. People have been calling for markets to decline for the past several years for all kinds of quantitative and technical reasons, like stocks trading above some of the widely known measures like the Schiller price to earnings ratio or central banks cutting money supply. We have all kinds of specific views about these that we would be happy to share with you.

What matters to us, however, are the fundamentals of economies and of the companies we invest in which give us the conviction to hold them or to buy more if their prices decline. While we are wary of the possible short-term impacts of geopolitical risks and monetary tightening on markets, we continue to believe that the fundamental drivers are intact for the companies we invest in to prosper for the remainder of the year and beyond.

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