Monthly Comment

INVESTING IN 2017…

> Political risk means all 2017 investment bets are off. To survive in 2017, investors will need to use tools taken not just from the world of economics, but from psychology, sociology and political science too.
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> The Financial Times, 31 December 2016

My grandfather, who was a newspaper editor, said that you should not believe everything you read in the papers. This year it feels like it would be best not to read them at all.

What is clear in 2017 so far is that not all investment bets are off, but all political bets are. The political turmoil in the US and in Europe has been astonishing, including the travails of the Trump administration, the Tory party's unexpected loss of its parliamentary majority in the United Kingdom and French president Emmanuel Macron's unprecedented majority in the parliamentary elections there. Politics are in flux and need to adapt to the challenges and opportunities of our globalized world, changing populations and technological disruption. Different paths are being taken in different countries and polarization is a risk. But change is good and robust exchange is welcome as long as it respects the institutions and laws that have allowed us to prosper for so long.

Political risk does not equal economic risk or company risk. Thank goodness we focus on the fundamentals of the companies we invest in, their quality and value, their franchises, prospects, managements and balance sheets. The tools we have, common sense, investment experience, understanding of how businesses work and financial analysis, have served us well. The performance of our portfolios has borne this out.

Market risk is the other risk that people often cite. Last year we experienced a drawdown in our equity portfolios around the US presidential elections. The "Trump trade" meant that fund managers did a "sector rotation". They sold the stocks of the quality and value companies we hold and they bought financials and cyclical companies. We circulated a graph showing how sudden those moves were and said that they were likely to be short lived and that they constituted a buying opportunity for us. And so it was.

We may be seeing something similar as we write: many of the stocks that have done well this year have just sold off 5-10% in a matter of a day or two. Technical trading, whether it is flows in and out of passive indices or ETFs, or trades generated by algorithmic or trend following funds, account for 70% of market volumes and perhaps as high as 90%. It makes no difference if it is people or computers just taking profits or the beginning of another rotation where they selling internet and technology stocks to buy other sectors. What we can say is that we will keep our eyes resolutely on the fundamentals and that if it continues, we have every reason to believe it will be as short lived as the rotation in November and as compelling a buying opportunity for our portfolios.

One of the key fundamental drivers for our portfolios is the growth in health and nutrition as a business opportunity. In emerging and developed markets alike it is driven by the needs of rising life expectancy, higher chronic disease prevalence, greater awareness of health and increased resources devoted to living longer and better lives. In our insight this

month, entitled Nutrition: The Next Frontier for the Consumer and Health Industries, Katerina Kosmopoulou writes about health and nutrition and the significant opportunity it represents for some of the companies we invest in. You can follow the link here or click on the attachment.

Equity portfolios

The World Stars Equity Portfolio performed strongly in May, rising +4.4% for the month and +20.7% year-to-date, both net of fees and in US dollars. Performance was broad based across the portfolio, with dominant franchise-driven internet and technology companies, global consumer products companies and global capital goods companies all contributing. The highlight this month, as for the year to date, was our position in Activision Blizzard, the leading e-gaming company, whose franchises include Call of Duty and Candy Crush. Activision was +12% in May and +52% for the year, making it the single best performer in the S&P 500. It is an example for the high quality franchise-driven businesses we look to invest in at good valuations and with the prospect of outstanding returns over many years.

We continue to be positive about the prospects for the high quality stocks in our portfolios whose businesses are prospering despite the tumultuous global backdrop. The fact that more cyclical businesses (including ones in our portfolios) that would be considered “value” investments by followers of Benjamin Graham have still not performed despite the economic recovery in the US, Europe and elsewhere makes us all the more optimistic.

Income-driven portfolios

The Income Strategy saw another strong performance in May +1.7% in US dollars (now +7.8% since the start of the year). Once again, equities contributed most (+4.3% with year-to-date performance now reaching +21.6%). The Fixed Income performance was more subdued (+1% for the month) although the general market conditions for the asset class were quite supportive with limited supply of new issues and positive in-flows from investors. Political issues in Brazil (see below) and the USA had little impact on markets although volatility increased slightly. The news of a higher level of oil reserves and subsequent sharply lower prices did not affect our energy-related corporate bonds.

The European Central Bank policy meeting offered little in the way of surprise for the markets and the ‘rescue’ of Banco Popular by Banco Santander created little waves in the credit space.

Our positioning on relative quality and short-duration investments is clearly bearing fruit and should provide further support going forward.

Emerging Markets bond portfolios

We continued to deliver strong performance in May for the Emerging Market Bond Strategy, adding +0.5% in US dollars, reflecting a continuation of the benign environment underpinned by range-bound 10 year US Treasury yields.

It was an active month in terms of trading activity as we continued to look for attractive entry levels in carefully selected companies as we think that investors will continue to have empathy for the Emerging Market asset class even though it might be only a carry play. We seized the opportunity of another political scandal in Brazil to initiate a position in the

country's dominant railroad operator, a name which had been on our watch list for a little while. Political uncertainties are likely to slow down the reform process without derailing our holdings' credit worthiness, whilst the Brazilian Central Bank has plenty of firepower to defend the Real and the current account deficit remains low (around 1% for the last 12 months).

Another example of our quality investment credo is Rusal, a top aluminium and nickel producer worldwide with 90% of its revenues generated outside Russia and focused on de-leveraging its balance sheet.

Of course we are not complacent about political risks, but we are optimistic about what matters most, the resilience of our institutions and laws, the US, European and global economies and the prospects for our companies.

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