Monthly Comment

SUMMER READING: ALEXANDER HAMILTON BY RON CHERNOW

"The period of John Adam's presidency declined into a time of political savagery with few parallels in American history a season of paranoia in which the two parties surrendered all trust in each other." *John Chernow, Alexander Hamilton (2004)*

"Let me warn you in the most solemn manner against the baneful effects of the spirit of party generally. (…) They serve to organize faction, to give it an artificial and extraordinary force; to put, in the place of the delegated will of the nation the will of a party, often a small but artful and enterprising minority of the community; and, according to the alternate triumphs of different parties, to make the public administration the mirror of the ill-concerted and incongruous projects of faction, rather than the organ of consistent and wholesome plans digested by common counsels and modified by mutual interests." *George Washington, Farewell Address written by Alexander Hamilton (1796)*

"Party animosities have raised a wall of separation between those with differing political sentiments." *Thomas Jefferson, letter to Angelica Church (1798)*

August is a time to catch up on summer reading. This year one of the books we are reading is Ron Chernow's authoritative biography of Alexander Hamilton, one of the founding fathers of the United States. Like with the investment greats, Benjamin Graham, Philip Fisher, Warren Buffett or Charlie Munger, reading the writings of the founding fathers or histories about how they devised a system of government that has led to unprecedented stability and prosperity for the United States and for much of the world, is always interesting and educational, and one can always find new insights and an astonishing relevance to issues facing us today.

Hamilton's policies have had an enduring impact. Working hand in hand with George Washington, the first president of the United States, he helped to build a strong federal government for the United States and to create the institutions that have shaped its government and economy until today. As the first secretary of the treasury he devised the US financial system along the lines it exists today, including the creation of the department of the treasury, issue of government bonds and creation of regulated public financial markets for stocks and bonds. As Chernow puts it, Hamilton "had prevailed in almost every major program he had sponsored [and] had laid the groundwork for both liberal democracy and capitalism."

What struck us particularly about how successful Hamilton's institutions have been and how they have survived for over two hundred years is that they were created at a time of great political disagreement and partisan discord that is reminiscent of our times. The conflict between federalists (the faction around Washington and Hamilton who advocated for a strong federal government with the power to raise taxes, issue debt and regulate the economy) and republicans (the faction around Thomas Jefferson and James Madison who envisaged a much more limited role for the federal government and stronger powers for the states, in part to accommodate different views about the abolition of slavery) was as populist and media driven as any issue we are facing today.

The fact that the United States has endured throughout the centuries is testament to the strength of the institutions put in place by the founding fathers. It also reassures us as we

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think about our responsibilities to preserve and increase wealth for generations. The United States has prospered over the centuries since Alexander Hamilton wrote the words above. It bears repeating time and again that focusing on the long-term fundamentals of politics, of economies and of companies is the way to achieve sustained returns without paying undue attention to short-term issues and turbulence. Alexander Hamilton by Ron Chernow is available on Amazon.com, one of our core holding, and is well worth a read.

We were also pleased that our investment case for Activision Blizzard, the leading video game company we wrote about in last month's insight piece on the emerging eSports industry, was recently picked up in a Forbes investment column.

Equity portfolios

Our World Stars equity portfolio continued its solid performance, closing July up 2.5% in US dollars, now up 21.8% year to date. Corporate earnings reported in July were broadly positive, reinforcing our view that economies in the US, European and elsewhere continue to do well. Given the strong performance of many of our positions year to date the reaction to positive earnings was mixed. In several cases there was a sense of travel and arrive with stocks pulling back on positive result affording us an opportunity to increase positions.

Performance was led by our position in Facebook which continues to show strong business momentum with more than two billion users worldwide, increasing levels of user engagement and higher advertising revenues. At the same time, we saw both Diageo and Anheuser Busch post strong earnings, the former through an inflection in its US whiskey franchise and the later by achieving higher than expected synergies from the integration of acquired SAB Miller.

On the negative side, we saw the broader tobacco space, including our holding in British American Tobacco, come under pressure as the US regulator, the FDA, announced a review of the levels of nicotine delivered through conventional cigarettes. This review is likely to be a multi-year process and the uncertainty may trouble short-term investors. However, we expect it to actually accelerate the adoption of next generation products and think it will turn out to be a positive driver for companies like BAT that have innovative and less harmful products as well as the scale to succeed in the marketplace.

Income-driven portfolios

The risk-on sentiment helped our income driven portfolios to another good month in July with a positive performance of 0.9% in US dollar terms (up 8.4% since the start of the year). Equities were again the main driver (up 2.6% on the month with year-to-date performance up 22.6%) followed by the positive contribution of the Fixed Income portion of the portfolio up 0.8% for the month (and up 5.7% year to date).

Global Fixed Income markets were broadly positive last month, resuming the spread tightening trend help by broadly positive corporate earnings releases, a more dovish than expected tone among major central banks and extremely low volatility (VIX at 20 years low).
Once again individual stories drove performance (see emerging markets comment) as well as cash generation (through coupons and dividends payments which accounted for 0.3% of the 0.9% improvement over the month).

In markets where returns are more difficult to come by we feel more comfortable than ever about the prospects for our research intensive approach to generate performance while minimizing risk.

Emerging Markets bond portfolios

July saw a recovery in risk appetite on the back of US economic data pointing to solid growth with little to no inflation, pushing out expectations of a Fed rate rise to early 2018. As a result of this benign scenario, Emerging Market bonds continued to benefit from inflows, both from institutional investors and ETFs. Our Emerging Market bond portfolio posted a 0.6% monthly return gross of fees.

Our main performance contributors in July were our Brazilian holdings, with Marfrig (Brazilian beef) leading the way up 3% more than offsetting last month' s decline. The company announced an expansion of production capacity at existing plants, clearly a move to gain some market shares whilst its rival JBS has been hit by a bribery scandal. We expect Brazilian credits to continue to perform well since corruption charges against President Temer have been rejected by the Congress, thus allowing the institutions to progress on structural reforms until the 2018 Presidential Elections.

Our Bahrain position posted a nearly flat return (+0.2%) despite its two notches downgrade by Moodys' to B1. The rating agency quoted a lack of efforts to reduce twin deficits caused by declining oil prices.

Despite some consolidation in Argentinean credits, they remain amongst the top performers year-to-date. We will look to increase our positions if volatility continues ahead of the general elections in October.

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