

Monthly Commentary

THE YEAR OF THE ROOSTER

People who count their chickens before they are hatched act very wisely because chickens run about so absurdly that it is impossible to count them accurately.

Oscar Wilde

It is the Chinese Year of the Rooster and there is quite a lot to crow about. The US and European economies have continued their strong performance, reflected in sustained economic growth, robust employment and rising markets. The US Fed is likely to put paid to Pimco's famous "New Normal" by raising interest rates at its March meeting today. Europe is not far behind and the ECB may change its posture before long. We have said for a while that the New Normal would be more like the Good Old Days. Eight years after the global financial crisis and 25 years since the beginning of globalization in earnest we have finally reached the end of deflation and are at the beginning of a sustained economic cycle that will last for several years. Political and economic events, not to mention market jitters, will offer opportunities from time to time but fundamentals will drive the performance of companies and of markets.

China is doing its part as well. Consider some of our analysts' comments on the recent results of companies in our portfolios:

<i>Tiffany 17th Jan</i>	<i>Sales in Asia: up 9% at constant currencies, strong retail growth in China and in wholesale in Korea, but softness elsewhere</i>
<i>LVMH 26th Jan</i>	<i>China +14% – helped by the government policy of repatriating spending to home</i>
<i>Diageo 27th Jan</i>	<i>Greater China registered 22% growth helped by early Chinese new year and share gain in deluxe and super deluxe categories</i>
<i>Swatch 2nd Feb</i>	<i>In China, demand increased by 20% in recent months, even higher in its own retail stores</i>
<i>Pernod-Ricard 9th Feb</i>	<i>China had a strong quarter up 4% due to early Chinese New Year</i>

The scale and strength of the Chinese market, the inexorable transition from investment-led to consumption-led growth and the government's determination to achieve an improved standard of living supports our positive view for this year and our conviction that the opportunities in China are as great as ever.

As China grows, this goes for Chinese companies as well as US and European companies. Alibaba, the Chinese internet giant envisions that "it will be a company that lasts at least 102 years". It has just announced a significant partnership with the International Olympic Committee to lead its digital transformation by providing it with global cloud computing and e-commerce infrastructure and extending the reach of the Olympic brand in China. Cloud computing is a key value driver for our positions in Amazon and Alphabet among others and it reinforces our conviction that China's leading internet company is taking such a step to participate in the development of this global industry.

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It is also important to us because of our interest in sports and sports finance. Our insight this month is an abridged version of an article we commissioned from Matt Tench, the well-known sports journalist, about China and its impact on football. President Xi's three wishes for China to qualify for a World Cup, host it and win it are another global ambition. Digital transformation, cloud computing, e-commerce and sports are a powerful combination that proffer growth and opportunity for the global economy and our investments.

Equity portfolios

It was another good month for the stocks in our portfolios and our World Stars equity portfolio, up 3.1% for the month in US dollar terms, bringing the performance to 8.0% year to date.

Performance was driven by solid returns and news flow across our holdings. *Activision Blizzard*, the leading video game publisher, in which we started building a position during January, was up 12.2%. The company reported outstanding fourth quarter 2016 earnings, benefiting from strength in key game franchises like *Overwatch*, as well as the ongoing transition to a digital format and the resulting deeper player engagement. Similarly, *Priceline*, the world's largest online travel agency, delivered a very strong set of results sending the stock up 9.5%, with room bookings well ahead of expectations supported by an overall healthy travel business and the ongoing secular transition to online booking.

Income-driven portfolios

The core multi-asset income portfolio returned 1.6% in February in US dollar terms, driven particularly by the 3.7% in the equity portion, but with all other components contributing positively. The higher quality companies in which we invest continued to recover from the relative underperformance vs. more cyclical stocks during Q4 2016. On the credit side the risk-on mind set supported high yield and emerging market corporate debt, which outperformed investment grade bonds.

The affirmation by the Fed's Janet Yellen of a planned rise in US rates this week, followed by a two likely further increases by the end of 2017, has already been discounted by the credit markets. The yield on US 10 year treasuries was steady at c.2.4% during February and has risen to 2.5% since her comments.

Our approach to investment grade credit remains focused on shorter duration and corporate bonds, which should be more defensive than Government bonds as interest rates rise and volatility increases. Notwithstanding this expectation of volatility we are encouraged by the upswing in the global business cycle.

Emerging markets debt portfolios

It was a good month for our emerging market bond strategy, up 1.2% in US dollar terms. It has now fully recovered the ground lost after the US election. Performance was driven particularly by our positions in Argentina and Turkey. *Clisa*, a leading Argentinian infrastructure company, marketed a \$100m secondary issue of its 9.5% 2023 bond, and this drew investors' attention to the much improved cash flow outlook of the business. Our holding rose by 4% in February.

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In Turkey, where we have 10% of the portfolio in three corporate bond issues, in February the yield on the 10 year US dollar Government bond has moved below 6% again after a period of volatility during 2016 when it traded from 4% to 6.1%. This reflects general bullishness around the asset class and significant inflows into emerging market bonds.

We have eschewed recent new issues, which mostly (and unusually) have been priced inside the secondary yield curve. As a result, we are running at 20% cash in our portfolio and waiting for better opportunities.

The quote about not counting chickens before they are hatched comes from Aesop in one of his fables. He is also credited with the saying “slow and steady wins the race” from the Tortoise and the Hare. We will try to keep all of this in mind as we pick and scratch our way through this Year of the Rooster and take advantage of the opportunities the uncertainties will offer.

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