

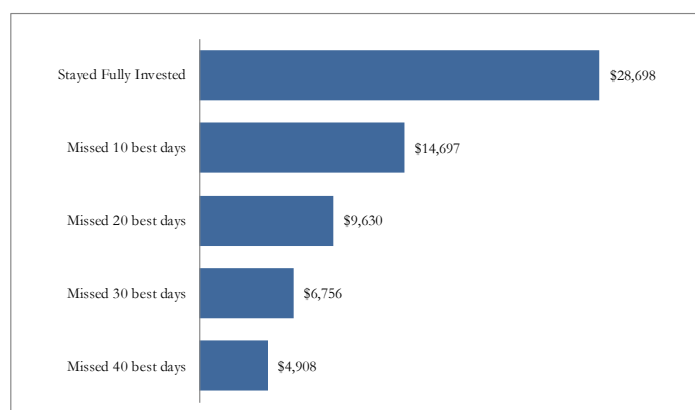
Monthly Commentary

TIME IN THE MARKET IS MORE IMPORTANT THAN MARKET TIMING

The Dow Jones Industrial index goes back to 1885 but is not the most fashionable these days. Its oldest constituents are GE (added in 1907), Exxon (1928) and Procter & Gamble (1932). Its most recent are Goldman Sachs, Nike and Visa (all 2013), Apple (2015) and DowDuPont (2017). Yet, it does not include any of the leading internet companies driving today's digital transformation, like Alphabet or Amazon, for the simple reason that their share prices are too high and their addition would distort this rather old school price-weighted index. Nonetheless, this exclusive historic club, where inclusion is at the discretion of the editors of The Wall Street Journal does still offer an important lesson in market timing.

The Dow has risen from its low of 6,600 in March 2009 to 23,000 today. Is it time to sell? Last month we talked about the fact that waiting to buy stocks at price/earnings ratios 10 or 20% cheaper valuations can mean losing the opportunity to make much higher returns over the long-term. Consider that from the end of 2001 to the end of last year, the rather old-fashioned constituents of the Dow generated a total return of 7.3% per year. \$10,000 invested then would be just over \$28,000 today. That is not bad for a stodgy index given its composition. Yet investors only realised that return if they were fully invested throughout. Market timing would have greatly reduced the returns. Missing the best 10 trading days would mean having \$14,000 today. Missing the best 40 trading days (just two days or so a year) would mean having just \$5,000. The difference is dramatic because the best days invariably follow the worst.

Dow Jones Industrial Average



This is because companies' share prices follow the creation of value over time, and value comes from the growth and profitability they have. That is as true today as it was in 1885 when the index was created.

What's more, digital transformation is about to impact even the most industrial component of the Dow. In our insight this month Katerina Kosmopoulou discusses another aspect of the digital transformation of our economies, the transformation of industrial production driven by the advances in digital technology. The catchword for this is the Fourth Industrial Revolution or Industry 4.0. We are indeed only just at the

beginning of this transformation, which will have significant impacts on the global economy and on the companies we invest in. Our insight outlines the issues, risks and opportunities we see.

Equity portfolios

The World Stars equity portfolio had a strong month, up +4.5% for the month in US dollars and is now +29.1% for the year-to-date.

Our holdings in the digital transformation part of our portfolio, including *Adobe* and *Alphabet*, did well supported by the underlying momentum in their businesses.

Adobe provided an update on its expectations for its business going into 2018 well ahead of market expectations. This is supported by the higher pricing that the company can extract from its subscriber base as it rolls out more products and features. At the same time, the company increased its outlook for the size of the market for their digital marketing business.

Alphabet, the parent company of Google, continued to grow revenues rapidly at 24%, significantly ahead of street expectations, with their mobile search business contributing greatly to this growth. Their paid clicks grew by a staggering 47% and despite the cost-per-click falling 18%, it still shows strong momentum and demand in the business. Alphabet now has an incredible \$100bn of cash on their balance sheet. As the business model generates such a significant sum of free cash flow, we wonder what Alphabet will do with this cash balance. It was interesting that they did not buy back any of their stock during the quarter which, whilst they have mentioned that it is their priority to invest in organic growth, we muse that they may pursue some large scale acquisitions in the future?

As in previous months our outlook remains solid, underpinned by the health of the global economy, despite increased geopolitical volatility. We have great confidence in the prospects of the companies we invest in. If markets sell-off as is possible given the strong performance so far this year we will look to take advantage to buy them at cheaper prices.

Income-driven portfolios

Following on the positive performance over the previous months, our income-driven portfolio performed strongly in October, with a positive return of +1.7% in US dollar terms, for a year-to-date increase of +11.8%. Equities had a very strong run, up +4.7% on the month with a remarkable year-to-date performance of +29.8%. Our portfolio of fixed income securities also performed well up +1.1% last month and now up +8.7% year-to-date, with more than 50% of the return coming from the generation of income. Demand for yield is still very strong and recent comments by central bankers were quite supportive for the asset class. As a result the primary market for higher quality issuers has been very active.

Following the particularly strong performance of the equities, in absolute and relative terms, we have rebalanced our portfolio to bring the various asset classes more in line with our central asset allocation: 30% Equities, 45% Fixed Income and 20% non-correlated funds. This means that we trimmed some of our equity positions that did particularly well and have initiated a new holding in *Essilor*. Similarly we have sold some of our long-term fixed income holdings to realise gains and re-allocate funds to relatively

higher yielding issuers.

Despite record tight credit spreads, our fundamentally focused process keeps uncovering attractive opportunities. Although it is possible that risk assets might pause as a result of possible profit taking and lower volumes into year end and of increased political noise with more Brexit negotiations, we believe that our holdings offer attractive returns for the short and the long term.

Emerging Market bond portfolios

The continuation of the benign scenario of synchronised global economic growth and subdued inflation has helped to push the performance of our Emerging Market bond portfolio further, up +0.6% for the month of October in US dollar terms.

Relatively stable US Treasuries (comforted by President Trump's dovish choice for the Fed chair) and strong investor appetite for Emerging Market debt encouraged lower rated issuers, including Mongolia and Ecuador, to seize the opportunity to secure cheap financing, although we did not participate in the issues.

Our Argentinean positions were the best performers, whilst our Turkish positions ended the month in the red. We are watching those closely and will be looking to allocate new cash at the right level.

In the current context of tight spreads, we remain very selective and discriminating in our asset allocation. October was an active month for the portfolio, as we took profit on two positions we had been holding since portfolio inception in October 2015, realising substantial capital gains and initiated new positions in deleveraging stories in Mexico and South Africa.

Chris Roszbach
November 2017

J. STERN & CO.

The Value of Long Term Investing

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