J. STERN & CO.

The Value of Long-Term investing

Monthly Comment

WISE INVESTMENT LESSONS FROM OMAHA: BUFFETT AND MUNGER ON ALPHABET AND AMAZON

> If we'd stayed with the classic Graham, the way Ben Graham did it, we would never have had the record we have. After nearly making a terrible mistake not buying See's Candy, [the first high quality business we ever bought,] we've made this mistake many times. We are apparently slow learners. If See's had asked $100,000 more, Warren and I would have walked — that's how dumb we were. [My friend] Ira Marshall said you guys are crazy — there are some things you should pay up for, like quality businesses and people. You are underestimating quality. We listened to the criticism and changed our mind. This is a good lesson for anyone: the ability to take criticism constructively and learn from it. If you take the indirect lessons we learned from See's, you could say Berkshire was built on constructive criticism.
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> *Charlie Munger, 'A Lesson on Elementary Worldly Wisdom' USC Business School 1994*

Berkshire Hathaway's annual shareholder meeting in Omaha provided a profound lesson in investment wisdom that has allowed Warren Buffett and Charlie Munger to generate unprecedented value over time. Buffett told shareholders that he should have bought Alphabet shares years ago. Management at Geico, Berkshire's car insurance company, told him that they were spending increasing amounts of their advertising budget with Google. He also admitted that he had missed other big technology stocks because he did not appreciate their value proposition. In an interview on CNBC's "Squawk Box" the Monday after the shareholders' meeting, Buffett said, "If I was forced to buy Alphabet or short it, I'd buy it; same way with Amazon. But it's as little hard when you look at something at 'X' and it sells at 10X to buy it."

Of course Buffet and Munger ended their discussion of the technology stocks they missed by stating the obvious: Berkshire has generated plenty of value even without those investments. Our greatest conviction is that quality and value will generate returns for the long-term. For us it was a striking lesson in how humble we have to be in constantly questioning our assumptions, to ground our decisions in rigorous analysis, to realize that we

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will make mistakes of substance and of omission, to always be open to constructive criticism and to always keep on learning from the people and the businesses we meet.

We are in the fortunate position to have seen the value of Amazon, Alphabet and other digital technology companies and have made them a core part of our portfolios. Last year we wrote in the Financial Times that it was still not too late for Berkshire to buy those companies. Buffett and Munger proved their skill by buying Apple instead, which has done well on hopes for the iPhone 8 and on repatriation of offshore cash. Still, Alphabet and Amazon have not done poorly, so with all humility we would say that just because Alphabet shares are up almost 20x since their IPO and Amazon more than 10x over the past decade, they still represent among the most compelling and profitable investments we know today and since we all believe in quality and value we would not be surprised at all if Berkshire came to a similar conclusion.

Last month, we arranged an event in association with Exponea, a London-based specialist digital marketing company, which helped to highlight just how large this industry will become over the next decade. Adobe Systems is another digital technology company that is a core holding in our portfolios. It is the world's leading digital marketing company. With a panel of speakers and audience ranging from technology executives to advertising agencies, marketing industry consultants, entrepreneurs and investors, we learned about some of the challenges faced and how the industry is likely to evolve. Our insight piece this month is written by Giles Tulloch which summarises what we learnt about digital marketing, its impact on virtually every company in our portfolios and the opportunities it offers them. Please follow the link below to read the insight or click on the attachment.

Equity portfolios

Markets have been supported by both the health of the global economy and the recent outcome of key national and regional elections. The US economy maintains its robust momentum driven by a solid labour market and levels of consumer spending. Importantly the recent earnings updates by US corporates also underlined the improving environment in the industrial end of the economy which had been lagging in recent years.
If this is sustained and indeed further supported by the proposed policies of lower taxes and higher infrastructure spending, economic momentum will accelerate. Increases in interest rates could trigger some market volatility, but ultimately any monetary tightening will simply be reflecting a solid underlying economy. In Europe, we are seeing a progressive recovery, driven by Germany and an improvement in the French economy. The election of Emmanuel Macron in France provides scope for a reform-led agenda both in the country and in the EU. Within Germany, recent elections at the state level point to continuity on the political front. In the UK, the economy remains resilient for now, helped by the devaluation of the pound, although inflationary pressures have started to affect consumer spending levels. China maintains a healthy economic pace, and other major emerging economies are benefiting from the recovery in commodity prices, however volatile, after years of depressed levels.

The main risk remains of course geopolitical, with Brexit negotiations and indeed the outcome of June's parliamentary elections in France, national elections in Germany, as well as the headline-making events in the US. In Europe, the hope of progressive reforms will now have to be translated into policy implementation, which doubtlessly will be met with heavy resistance. In this economic and political environment we reiterate our conviction in

our strategy of 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.
The World Stars portfolio is up 3.4% for the month and is now up 16% for the year and 54% since inception in October 2012 in US dollars. Performance in the portfolio was driven by solid earnings reports across our holdings.

Alphabet, the parent company of Google, continued to grow revenues at over 20% benefiting from the secular growth in digital advertising, whilst solid cost control translated into further margin expansion and supporting earnings. *ThermoFisher*, the global leader in Life Sciences products in which we invested in at the beginning of the year, also posted stellar earnings driven by the momentum across its end markets (which range from academic to pharmaceutical and industrial) as well as strong execution on the integration of its recently acquired businesses. Among our industrial holdings, *United Technologies* posted exceptional earnings underpinned by the strength in both its global aerospace and construction businesses.

Most if not all if the companies, whether in consumer, technology or cyclical industries, reported strong outlooks for the year despite the political uncertainties in the United States and Europe, which makes us optimistic from a fundamental perspective for the remainder of the year.

Income-driven portfolios

April was another strong month for the Income Strategy up 1.6% in US dollar terms and now up 6% for the year. All asset classes had a robust showing but the charge, once again, was led by Equities (+3.3% for a year-to-date performance of +16.5%) Fixed income (up 1.8% over the month) benefitted from political uncertainty ahead of the French Presidential election and some disappointing US economic data with somewhat of a flight to quality. The ECB reduced purchase programme had little impact on the asset class in Europe. In addition, emerging market debt was supported by high level of demand from investors looking for higher yields.
With most pivotal political risks behind us, markets could resume their up trends supported by the global cyclical upswing. Possible upward surprises in inflation and further central banks tapering later this year could temper this positive mood.
Our focus remains companies' fundamentals and their ability to generate cash, compound their growth whether in equities or in the credit space.

Emerging Markets bond portfolios

April delivered a good performance for the Emerging Market Bond portfolio, up 0.9% in US dollar terms gross of fees. All our holdings had a positive return, led by our positions in Argentina and Turkey. S&P's upgrade of Argentina to B from B- (stable) early in the month propelled our allocation by over 4% on the month for a total return of 12% since the beginning of the year. We feel that current prices fully reflect the improved macroeconomic environment and do not take into consideration the potential volatility ahead of October's general election.

Turkey as expected, withstood the referendum results. Our Turkcell holding ended the month up 2.5%. We did not take part in the Sovereign and bank new issues.

In spite of the relative tight spreads situation, we are currently focusing our research efforts towards deploying cash into selected carry plays and solid quality names, which would comfortably withstand any market-led volatility.

The strong performance of our portfolios despite the political uncertainties highlights the importance of keeping the focus on businesses their performance and their valuations. With the positive outlook we see we are optimistic about our portfolios as well. Volatility is at a low not seen for decades and we must expect it to increase. However like Warren Buffett and Charlie Munger we believe that volatility is our friend because it allows us to buy the great companies we invest in at lower prices.