Investment commentary

MARKET ROTATION AND OPPORTUNITY

One of our long-standing convictions is that volatility is an opportunity not a risk for long-term investors. Stock prices follow fundamentals and pull-backs like the one we experienced in March of last year allow us to buy great companies at lower prices. We took advantage of it last year and initiated positions in companies like Givaudan, Alcon, Sika and Amphenol, global leaders in their fields with great prospects for growth and value generation.

But volatility is only one of the sources of opportunity in markets. Market rotation is another. Over the last six months, shares in companies that have been subject to disruption over the last five to ten years and that have been materially affected by the pandemic due to their cyclical exposure, high fixed costs or high capital intensity, have outperformed significantly. By contrast, companies that have prospered over the past decade and continued to do well last year even during the pandemic, have been held back. The move has accelerated over the past month. A graph of the 'value' vs. 'growth' components of the S&P 500 shows that it is almost a 20% divergence between outperformance of value and underperformance of growth over this short period.

Our approach is fundamental and we have exposure to many different types of companies. It is remarkable how far the rotation has gone in terms of the valuation of many of the companies in our portfolios that delivered strong results last year and have prospects for even greater progress this year and going forward. The rotation has left the digital platforms like Amazon, Alphabet and Facebook at valuations that are now outright cheap and at the lowest premium to the overall market since their listings.

If the trade for the past six months has been 'value' in the typical sense we are convinced that the long-term trade is to invest in companies that offer quality and value in the long-term: quality in terms of exposure to good and growing markets, strong and sustainable competitive positions, good managements and strong balance sheets, and value in our sense of delivering returns of 8-10% or more over the long-term. They have delivered significant value over the past decade and have great prospects to do so over the next decades as well.

We have to remember that the concerns around inflation and interest rates come from the positive outlook for the global economy. The pandemic had a significant impact on the global economy and on markets. It brought the service economy to a halt, the major source of employment and income for the US and European economies. Governments and central banks stepped in to support their economies through the crisis, preserving businesses, employment and incomes through furloughs and other measures.

One year on, research, technology and innovation has allowed for the development and production of vaccines and therapeutics that will help to overcome the virus. Globally leading companies, including many that we own in our portfolios, have played a critical role in these efforts as we have discussed throughout the year. Most of the attention has been on the Pfizer BioNTech, Moderna and Astra Zeneca vaccines that are being rolled out globally. The recently approved Johnson & Johnson vaccine is highly effective, in particular against severe outcomes including the emerging variants, and will be produced in great quantities as well.

Another source for optimism is the increased availability of therapeutics that improve the treatment and outcome for those affected by the disease. Glaxo and Merck have both

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recently announced the results of clinical trials for medications that significantly improve the prospects for those experiencing serious cases and that will add to already existing treatments.

Supply shortages, roll-out and acceptance will be issues through this year but the US and Europe should be in a position to vaccinate anyone willing throughout the summer and the 'shambles' is mostly about availability of early supplies. The most recent headline from the US is striking: The US government will ship millions of doses of the Astra Zeneca vaccine to Canada and Mexico because it is not yet approved by the FDA, but also because it clearly is not needed to achieve the goal of offering vaccinations to all US adults by July. Several states have already opened eligibility to all adults and others will follow. It is an impressive achievement and shows what a country can do if it is the US.

Thankfully, pandemics are few and far between but to the extent they can be researched they are followed by the shortest and strongest recoveries compared to other economic and market dislocations. Markets are increasingly pricing in a return to normality as vaccinations and improved therapeutic protocols start to have a significant effect on case numbers and fatalities.

Our insight this month is in a different format than usual. We have been proud to sponsor the Oxford University Business Economics Programme series of lectures on the Economics of Post-Crisis Recoveries as part of our commitment to supporting public discourse about important, political, economic and social issues. We would like to share a video discussion we had with Oxford Economics Professors Hamish Low and Michael McMahon 'Conversation on Lessons Learned from the Pandemic', in which we discuss the economic impacts and in particular the ways in which to overcome the human cost in terms of opportunity and education that is one of the major issues as we emerge from the pandemic. You can watch it by following the link here or by opening the attachment.

We now expect a strong recovery to take place this year, similar to what we experienced after the 9/11 crash in 2003 and the global financial crisis in 2009. We welcome a new cycle of economic growth, employment, wage increases, inflation and interest rate rises, all of which we hoped for after the global financial crisis when we worried about a 'New Normal' and a global economy afflicted by Japanese-style global deflation.

Like in 2003 and 2009 concerns about inflation and interest rates are vocal and markets react short-term. Risk assets have entered a classic 'post-recession' transition phase, with a sharp steepening of the yield curve. The 10-year US treasury yield has gained almost 60 basis points over the past couple of months, triggering asset re-allocation from long duration/defensive assets to shorter duration/cyclical assets and increased volatility. As we have said in previous commentaries this corrective phase generally happens as the economy heads towards normality, and ahead of what could be exceptional global economic growth over the next couple of years.

Our focus remains resolutely on the long-term, and what a post Covid-19 world is likely to look like. We expect structural shifts like remote working, e-commerce, digital engagement and automation to continue unabated. At the same time, health & wellness and sustainable living, which have increased in importance in the minds of consumers, will continue to be important themes well after this crisis has abated. And finally, investments in healthcare capacity and green infrastructure are likely to fuel the healthcare and industrials industries for years to come as governments learn the lessons of Covid-19 and look to safeguard national resilience. We see all these trends as playing to the strengths of our holdings and we continue to add opportunistically to positions and explore new investment ideas.

That is why we have used the opportunity of the rotation to add an initial position in Salesforce, the leading enterprise software company. The company has significant long-term growth and value generation potential in the years ahead and the recent pull-back in the share price has given us an opportunity to initiate a position in the stock.

World Stars Global Equities

Our World Stars Global Equity strategy closed up +1.2% in US dollar terms in February. It is slightly down for the year, at -0.9%, lagging global markets, with deeply depressed parts of the market continuing to rebound. However, this follows significant outperformance for the strategy last year.

Performance during the month was led by some of our companies that had suffered as a result of the Covid-19 pandemic during 2020. The top performer for the month was lenses and frame manufacturer *EssilorLuxxotica,* which has rebounded strongly due to market anticipation of a resurgence in demand for its sunglasses brands, including Ray-Ban and Persol, as global travel resumes and to increasing clarity on the company's long-term, post-merger governance structure.

Our holdings in *Mastercard* and *Visa* were also strong for the month. These payments companies had suffered last year as their higher yielding cross-border activity was affected by the halt in global travel. Throughout last year, the companies benefited from the accelerated shift to online and cashless purchasing, whilst travel-related activity has already been rebounding where travel corridors have reopened (for example between the US and Mexico or the Caribbean) suggesting that pent-up demand will drive a sharp recovery this year. Longer term, contactless payments, online purchasing, B2B services and value-added offerings will all provide additional tailwinds to growth.

Several of our industrial holdings posted positive returns, including *Eaton*, *Raytheon Technologies* and *Honeywell.* All three companies stand to benefit from a rebound in travel activity, given their commercial aerospace exposure, while Eaton and Honeywell should also see improving trends in areas like construction, transportation, and energy. Importantly for us, these names emerge from the crisis as stronger players, having shielded their profitability and cash flow during the downturn through swift mitigating action and having used their balance sheets to buy assets where strategic opportunities emerged, magnifying their potential earnings recovery.

Weaker during the month were some of our Covid-19 beneficiaries, including life sciences leaders *ThermoFisher* and *Becton Dickinson*. Both companies have been beneficiaries of global testing demand which they anticipate will continue to do well through 2021. ThermoFisher has benefited more broadly given its unparalleled product and service offering to the pharmaceutical research and production industries. Though relative earnings momentum may lag some of the pure Covid-19 recovery plays in the year ahead, we see these companies as structural winners within their industry over the long-term. They will benefit from increased healthcare spend, both in the form of system resilience investments and/ or pent-up demand from postponed elective procedures as hospital capacity across many countries became overwhelmed at the height of the crisis.

During the month, we added a position in Salesforce, the leading enterprise software company. Its software is specifically designed for front office, customer facing roles. The Covid-19 crisis has accelerated digital transformation trends and Salesforce has experienced strong demand for its software as businesses have looked for ways to better engage with their

customer base. We have followed Salesforce for years and expect it to deliver significant growth and value for our portfolios.

Multi-Asset Income

The month of February saw a positive return of +1.2%, more than recovering the loss of the previous month and taking the year-to-date performance back into positive territory +0.3% both in US dollar terms.

Last month we saw a positive contribution from both equities and fixed income. Equities bounced back strongly by +2.4% (now up +0.5% year-to-date) whilst fixed income continued its steady recovery with a 0.9% positive return for the month (now up +1.1% year-to-date). By contrast, the non-correlated income funds witnessed some weakness, falling -0.7% for the month (and leaving them down -1% year-to-date), which includes the impact of volatility around the capital raising for the Hypgnosis fund.

The equity portfolio benefited from broad contributions from various sectors, with digital disruptive equities such as *Activision* and *Alphabet* performing strongly alongside economically sensitive and post Covid-19 recovery stories like *Medtronic*, *Eaton* and *Mastercard*, all of which contributed to the general strength of the asset class. Strong earnings releases provided the main source of support.

The credit portfolio's steady performance was grounded in upbeat earnings releases, with positive flows also coming into the asset class as investors continue to chase income. The strong oil price was another plus, particularly for names like *Tullow* and *YPF*, with upwards momentum seen broadly in both developed and emerging market bonds.

The recent increase in volatility did not come as a surprise and we have paid particular attention to maintaining our asset positioning across the strategy. This means the portfolio can benefit from the secular change towards digital transformation represented by the global technology leaders we hold in the equity portfolio or by smaller companies such as Douglas AG, the German beauty, skincare distribution specialist that has transformed itself into an e-commerce champion in the sector and that we hold in our credit portfolio, whilst also seeing gains from more industrial, economically sensitive equities such as *Eaton*, *Honeywell* and *Raytheon*.

The credit portfolio is set up to benefit from a very short duration (2.5 years), which should shelter it from rising interest rates.

Last but not least, our trade finance funds are starting to see the light at the end of the tunnel, and we expect the environment to improve further due not only to the roll-out of vaccinations globally and the general re-opening of the global economy, but also from rising commodity prices that will support overall activity.

Emerging Market Bonds

February saw the yield on the benchmark 10-year US treasury note rise more than 0.3%, exceeding 1.5% for the first time in over a year and marking the largest one-month rise since November 2016. The move was fuelled by bets that the Fed may start raising interest rates earlier than previously expected in response to what investors widely expect to be a burst of economic growth and inflation later this year. The speed of the move unnerved markets, causing a broad-based sell-off towards the back end of the month for both bonds and

equities. Despite this, our emerging market bond strategy held up well, returning +0.2%, taking year-to-date performance to -0.1%.

The top contributor to performance this month was *YPF*, the state-controlled Argentinean oil & gas company, which was up 6.4%. The group concluded a liability-management exercise that extended its debt maturity profile and provided short-term cash relief, which can now be directed towards capex. Bond prices recovered from an initial sell-off given the improvement in economic terms offered in the exchange, and management can now turn their attention to the business plan ahead, which is focused on increasing production in a more supportive oil price environment.

The biggest detractor to performance was *TV Azteca*, the Mexican TV broadcaster, which was down 21.9% for the month. The company announced that it is looking to restructure its debt given the decline in the TV advertising market which has been exacerbated by Covid-19. It decided to defer the upcoming coupon on the bond whilst it holds talks with noteholders. Bonds were negatively impacted by the news, reaching levels last seen during the March 2020 sell-off which we believe is a floor given the company's catalogue of content and PPE which provides a certain level of asset coverage.

During February we made one addition to the portfolio, adding *Tullow Oil*, an African-focused oil and gas company. The group had some liquidity concerns last year which were further exacerbated by the drop in oil prices, resulting in a sell-off of the bonds. After a number of recent positive developments, including asset sales to improve liquidity and the recovery of oil prices, we feel that the story has significantly de-risked while the bonds still offer a very attractive yield to maturity of over 13% for a four-year duration.

As economies continue to recover and we see a rebound in global growth, we expect interest rates to continue to increase moderately. However, while this is negative for bond prices, we are confident with how our portfolio is positioned. Duration is low at only 2.4 years, which will reduce the sensitivity of our portfolio to rising rates, while still providing an attractive current yield of 6.6%.

We hope you remain healthy and well as most of us look forward to the roll-out of the vaccines over the next few months, and please let us know your questions and comments.

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