J. STERN & CO.
The Value of Long-Term Investing

Investment Commentary June 2021

BACK TO LIFE, BACK TO REALITY

"Back to life, back to reality, back to the here and now…"

Soul II Soul, 1989

Every once in a while we think of song lyrics that encapsulate the moment. Of late these have ranged from "Here comes the sun" to "We get knocked down but we get up again". The song of the moment has to be Soul II Soul's 1980s hit 'Back to Life', with its refrain: "Back to life, back to reality…". This may say more about our questionable taste in music than anything else, but it is an apt expression for the current turning point in the pandemic.

Just yesterday New York City celebrated the lifting of Covid-19 restrictions with a fireworks display to honour the essential workers who have helped the city to get through the pandemic. Conversely, the UK has had to postpone the lifting of restrictions out of prudence because of a surge in infections among younger people, but it is not far off. The full reopening of our economies and the return of normality to our lives is thankfully now a question of when, not if.

As we highlight in our Insight this month, the outlook for finally overcoming the virus now depends upon the efficacy and availability of vaccines. It has been more than a year since the World Health Organization declared Covid-19 a pandemic. Looking back, it has been an extraordinary period in all our lives. Our world has changed. But the devastation of the pandemic has also given rise to unprecedented scientific advancement as we have risen to the challenge. In less than a year, several highly effective Covid-19 vaccines have been developed, approved and delivered. Mass vaccination is well advanced in many parts of the US and Europe, and concerted efforts from rich countries to help vaccinate the rest of the world are crucial in the race to bring the pandemic and variant epidemic outbreaks to an end.

The pandemic is as fast moving as the response. The first vaccines have succeeded in halting its progress, but we now face rapidly emerging variants and the likelihood that boosters will be needed to maintain protection. Our Insight sets out the current state of research around the development of vaccines and boosters and why we believe they will work. You can read it by following the link or clicking on the attachment.

We are getting back to life and back to reality, and we see opportunities everywhere. A pandemic is among the shortest, sharpest exogenous shocks that can occur. People want to get back to work and to enjoying themselves, closed activities and projects are restarting, and there is significant pent-up demand for almost all types of goods and services.

The reality is that of course there will be shortages of labour and goods as furlough programmes roll off and supply chains are restarted, and also there will be spikes of inflation where supply is not yet able to cope with resurging demand. There will also be a slowdown after the recovery next year when growth will slow or turn negative as it annualises the strong growth of this year. But these are short-term, temporary effects. They are caused by economic recovery and are a positive to be welcomed as a harbinger of the return to growth

J. Stern & Co
4 Carlton Gardens
London SW1Y 5AA
United Kingdom

Tel: +44 20 3478 1800
Fax: +44 20 3478 1799
info@jsternco.com
www.jsternco.com

and prosperity. Governments and central banks are fully aware of these dynamics, and there is no reason to believe they will not do what it takes to balance the normalisation of fiscal and monetary policy with the need to support the recovery and offset short-term effects.

Most if not all of our companies are poised to benefit, from *L'Oréal* in cosmetics as people go back to work, to *Diageo* and *Pernod Ricard* in spirits as they go back to socialising, *Alcon* in eyecare as elective surgeries resume, and *EssilorLuxottica* in sunglasses and lenses and *Mastercard* and *Visa* in payments as they go back to travelling and spending time outdoors. These companies have the growth prospects, competitive positions, scale and pricing power to participate in the recovery and to offset inflation with their growth and operating leverage.

If back in 1989 Soul II Soul had invested the proceeds of their hit in stocks, they would have done well. The record shows that for long-term investors, market volatility is not a risk but an opportunity to buy more for less. The same is true for market rotation, like the one between value and growth that we have seen over the past six months. This has likely now come to an end, which has allowed us to add a position in Salesforce at much lower prices than before. Our focus is on these opportunities, and we will look to take advantage of any volatility that occurs.

World Stars Global Equities

Our World Stars Global Equity strategy continued on its positive trajectory in May, closing the month up 1.2% and bringing performance year to date to 10.7% (both in US dollar terms).

Performance was led by our holdings in consumer and industrial companies as the acceleration of vaccination programmes and progressive reopening of economies fuelled their earnings recovery. The top performer was leading haircare and make-up provider *L'Oréal*, which was up 8% as the company benefits from ongoing demand for upscale skincare products across markets and as it leverages its industry-leading e-commerce distribution capabilities. As consumers start returning to the office or restaurants, demand for make-up and fragrances is also coming back, providing further tailwinds. Similarly, spirits producers *Diageo* and *Pernod Ricard*, both up 5% during the month, have been seeing a robust recovery in sales as the on-trade channel has opened up again, with Diageo also reinstating its GBP 1 billion stock buyback programme, a sign of its increasing confidence in the improving outlook for the market.

Within industrials, *Raytheon Technologies* continues to recover and is up 7% during the month. The company hosted its first investor day since last year's merger of United Technologies with Raytheon. There, the company provided a confident outlook for the period to 2025, upgrading its targeted synergies, free cash flow and capital return to shareholders. The company also highlighted long-term opportunities that will arise from the electrification and digitalisation of aerospace, which Ratheyon is well placed to capitalise upon given its expanded technology platform since the merger. In the shorter term we expect the stock to be well supported by the ongoing recovery in commercial aviation, with passenger volumes expected to reach 2019 levels by 2023.

Also within industrials, construction chemicals company *Sika* was up 6% as the company continues to benefit from robust construction trends globally and the expectation that infrastructure stimulus programmes such as the US administration's USD 2 trillion bill will support spending going forward. At the same time, the company continues to be a consolidator in its industry, reflected in its recent acquisition of Japanese peer Hamatite.

Finally, within digital transformation, gaming software publisher *Activision* posted another set of exceptional results, driving the stock up 7% as the company's Call of Duty franchise continues to show strong momentum, with mobile and in-game micro-transactions gaining traction as incremental revenue streams. In all, Activision has built a monthly active user base of over 400 million people, exiting the pandemic with a significantly expanded player base which it will be able to monetarise in the years ahead.

Multi-Asset Income

Following the strong month of April, May saw the continuation of the positive momentum witnessed so far this year. All asset classes contributed positively for an overall return of 0.6% over the month and are now up 5.2% since the start of the year (both in US dollar terms).

While equities were the strongest performer with a 1.2% positive return for the month (up 11.4% since the start of the year), the credit portfolio carried on with its steady recovery and a positive 1.1% contribution for the month (it is now up 3.2% since the start of the year). The non-correlated funds were up 0.6% for the month, meaning they are now up 0.9% for the year.

As discussed last month, with a few exceptions risk asset classes have been supported by varied US economic data, strong corporate performance across many sectors and renewed supportive talk by central bankers despite strong signs of inflationary pressures starting to emerge globally. Most commodity prices are at record levels, and even oil prices, still struggling from an uncertain supply–demand picture, are steadily on the path to recovery. This benefited some of our credit positions this past month, such as *YPF*, *Seplat* and *Tullow*.

Some of the recently added financial issuers, like *Akbank* and *Banco do Brasil*, have also benefited from the expectations of higher interest rates at some point in the future.

As economies reopen and investors including ourselves enjoy the sunny weather as spring turns into summer, we believe it is possible that with the very strong corporate earnings season now behind us, risk assets could be susceptible to renewed bouts of volatility that could be triggered by a sudden rise in bond yields or concerns around higher taxes in the US. Mixed economic data from the US seem to have so far delayed expected talk about the US Federal Reserve tapering its bond-purchasing programme. As much as we are still very constructive about the outlook for our investments for the rest of the year, central banks will also adjust their policies as most large economies go back to normal.

We continue to focus on investment opportunities which are well positioned to generate strong cash flows with deleveraging potential which we hold to maturity. Our strategy has already generated 2% of our targeted 5% annualised cash yield this year, and we believe that our current positioning will allow our strategy to prevail through any volatility.

Emerging Market Bonds

The EM bond portfolio had another good month as it went up 0.8%, taking year-to-date performance to 1.7% (both in US dollar terms). Yields on the benchmark ten-year treasury note were stable at around 1.6% despite concerns about rising inflation, with the positive performance being driven by tightening credit spreads.

Banco do Brasil, the largest bank in Brazil, was the largest contributor to performance in May, with a return of 4%. The bank reported solid results for the first quarter of the year driven by much lower loan-loss provisions, whilst also seeing loan growth increase, which should drive revenues going forward. Strong macroeconomic activity indicators pointed towards better-than-expected first quarter GDP in Brazil, which also supported prices.

YPF, the Argentine state-controlled energy company, also had a strong month, generating a return of 3.3% after reporting very strong results for the first quarter, driven by a partial recovery in production and better commodity prices in the upstream business in combination with increases in fuel demand and better pump prices in the downstream business.

Finally, our Ukrainian holdings, *Kernel* and *MHP*, recovered as geopolitical risks eased after Russia withdrew troops from the Ukrainian border, providing a more constructive backdrop in the region.

We continue to diversify our portfolio. This month we added an additional issuer, *Unigel*, which is an intermediary chemical producer in Brazil and Mexico. Demand for its end products is set to benefit from the macro recovery, which will be supportive of spreads in the near term, and so we felt that the current yield of 8.1% for the 2026 notes was very attractive for a company with a leading market position, an improving business profile and a track record of deleveraging.

We are very pleased with how our corporates have performed throughout the pandemic. Recent first quarter results have reinforced our confidence in the strength and resilience of our holdings and the ability of our portfolio to generate an attractive yield in different market conditions. Looking ahead, the emerging markets asset class should continue to benefit from the upward trend in commodity prices and the reopening of economies as vaccination

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