Investment Monthly Commentary

What's Possible

"I think about all the young kids who will be watching this summer. No matter what happens, I just hope that their parents, teachers and club managers will turn to them and say, 'Look. That's the way to represent your country. That's what England is about. That is what's possible.'"

Gareth Southgate, England football team manager

As with stocks, so it is with football: sometimes you win, sometimes you lose. The Euro 2020 competition was inspiring and contained so many of the hard-fought matches, upsets, heartbreaks and triumphs that are part of the game.

England made a major final for the first time since 1966. Although we have a long-term investment horizon and the Stern family has investments like Nestlé and Roche that go back to the 1950s, even we think that is quite a long-term dedication to a goal. England might have lost the final, but the quality of the team undoubtedly shone through in their pride, determination and passion.

Gareth Southgate's inspiring letter to 'Dear England', written at the beginning of the competition in June, is as much about the England team as it is about most others: about the incredible privilege of representing your country, and how doing so is a result of great character, determination and discipline on the behalf of the players as they represent their families and communities. Many of the players come from backgrounds where their families have immigrated to the countries they now represent, and have had to overcome social and economic disadvantage and adversity. Not everyone can become a national team football player, but their diversity and accomplishment shows what is possible and is a true inspiration in these difficult times.

We also believe in a 'long game', and we are pleased that our prediction that the value-to-growth rotation would be a good investment opportunity has been proven right. The rotation has now fully reversed and our stocks are back to outperforming the wider market. Quality has proven to be the key factor in winning against the competition, and we will look to take advantage of volatility and other market-related moves whenever opportunities present themselves.

At the outset of the Covid-19 pandemic we had thought that there would come a point when vulnerable populations and healthcare workers would be vaccinated so that healthcare systems would have sufficient resources to cope. Although many are still affected by the disease, thankfully we appear to be in the midst of this decisive phase. Vaccines have been rolled out to those populations most affected by the virus in the United States and the United Kingdom. Roll-out in the European Union has lagged, but the European Commission has just announced the imminent distribution of sufficient doses to its member states, and this will hopefully be achieved throughout the summer.

The Euro 2020 matches played at Wembley Stadium marked a key moment for the UK government's response to the pandemic that will have implications for other countries, given

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the population size and concentration of the crowds. Mass gatherings like that will be likely to lead to increasing infection among the mostly younger non-vaccinated population. The trade-offs between public health and economic impact are difficult, and we will have to assess the impact in terms of serious outcomes, hospitalisation and mortality. As we outlined in our Investment Insight last month, we have to closely track variants of concern, and there is a risk that new variants will not follow the expected path of higher contagion but lower potency and harm, but so far the existing vaccines and likely boosters should allow a return to greater normality through the second half of the year.

We believe that sustainability and long-term investment returns are inextricably linked. Sustainable returns can only be generated by companies that have sustainable competitive advantages as a result of the sustainable way in which they operate. Because of this we see the increasing importance of ESG issues as an opportunity for the companies we invest in. Our recent commentaries have covered our ESG framework and its associated investment aims, as well as our implementation of our framework in our investment approach. This month we have written the first of a series of Investment Insights about key sustainability issues affecting the companies we invest in. We start with an in-depth perspective on plant-based nutrition and the opportunities and risks it has for the food and beverage industry.

As we look forward to the second half of the year, the elements for a strong recovery from the pandemic are in place, demand is strong and bottlenecks in labour, inputs and raw material will be overcome as supply increases. There will clearly be short-term spikes in inflation, there will be difficult comparisons after the strong growth we will see this year, and there is likely to be market volatility, but the underlying fundamentals are strong and governments and central banks have every incentive to continue to moderate the impact and support the transition.

For that reason we are hopeful about our ability to overcome the pandemic, positive about the outlook for our investments and determined to take advantage of any opportunities that volatility will afford.

World Stars Global Equities

Our World Stars Global Equity strategy closed the month up 2.8%, bringing performance year to date to 13.8% (both in US dollar terms).

Performance during the month was led by *Adobe*, the creative software provider, which was up 16%. The company posted solid Q2 earnings with 23% revenue growth as activity in the small and medium customer segment improved significantly, especially in the US. With solid momentum across both the enterprise and education end markets, we see Adobe as well placed for the quarters ahead.

Performance was also solid amongst our holdings in the healthcare industry. Pharmaceutical giant *Roche*, up 12%, benefited from news that US regulator the FDA had approved its peer Biogen's Alzheimer's drug Aduhelm. This disease had previously proven notoriously difficult to develop drugs for, and it is significant that the FDA accepted Aduhelm because using the drug showed a reduction in amyloid plaque reduction in the brain. Usually the FDA would insist on evidence of cognitive improvement in patients, but this opens the door for further approvals in the sector, such as for one of Roche's own drugs, gantenerumab, which is currently in phase III trials. If approved, this could present a multi-billion-dollar opportunity for Roche, driving the upside of the stock.

Optical lens and sunglasses producer *EssilorLuxottica* closed the month up 10% thanks to a favourable arbitration decision in the ongoing dispute between the company and GrandVision, the optical retail chain it had been seeking to acquire. This paved the way for the EUR 7.2 billion deal to be closed. The acquisition of GrandVision's 7,000-store network further strengthens Essilor's presence in key markets and places it in a strengthened position to capture the recovery in global consumer demand as economies open up post-Covid-19.

Also in the healthcare sector, we saw life sciences leader *Thermo Fisher* rebound 8% as the market started to look beyond the inevitable normalisation of Covid-19-related testing revenues. Unlike other peers in the sector, the company benefits from late-cycle pandemic-related revenue opportunities, including vaccine production-related ones, whilst its recent acquisition of clinical research provider PPD opens adjacent revenue routes for the future.

On the weaker side during June were our holdings in the industrials sector, including *Raytheon Technologies* and *Honeywell*. These companies have enjoyed a significant recovery during the last year, with some inevitable profit-taking as the market anticipated the reopening of the global economy and a rebound in industrial activity. We believe, however, that both companies are in the early innings of a multi-year recovery period, led by the progressive normalisation of key industrial verticals as well as by structural trends in the sector, including the digitalisation and electrification of the global economy.

Multi-Asset Income

The month of June saw a positive return of 1.5% in US dollar terms, taking the year-to-date performance to 7.3% following on from the steady performance of the past few months.

Once again equities enjoyed very strong performance last month, and were up 3% in US dollar terms (and are now up 15.1% since the start of the year). Whilst the credit portfolio's recovery continued with a 0.9% positive return for the month (and a 4.3% positive return year to date), the non-correlated funds suffered a small setback and were down 0.7% for the month (and are now down 0.9% since the start of the year).

A flattening of yield curves globally, supported by a somewhat more hawkish US Federal Reserve (with earlier-than-expected interest rises in the US to keep inflation under control), triggered a strong response from our high-quality growth equity holdings, whilst our credit portfolio benefited from some further spread compression and the strength of the oil price, led by *YPF*, *Pemex*, *Seplat* and *Millicom*.

The US economy exceeded its pre-pandemic peak last quarter, and companies' profits are close to or above peak levels. The best of global growth is soon to be reached as economic indicators point to a peak in economic recovery growth momentum. This, combined with renewed concerns about a possible new wave of Covid-19 infections due to the new Delta variant, could provide the markets with a summer correction. Nevertheless, we are still constructive about the rest of the year because central banks will remain very accommodative and some fiscal stimulus packages will only start to have an effect in the second half of the year. As we continue to move back towards normality, policy and market adjustments should be expected.

Over last month we decided to gradually reallocate some of our equity exposure in favour of corporate bonds, due to our equity portfolio's remarkable performance year to date and our overall objective of low volatility. However, we also believe that such market moves will provide us with opportunities to buy some assets at attractive prices whilst generating superior income.

So far this year the cash yield generation has been close to 2%, and the second half of the year should see further income growth as well as the potential for further capital gains.

Emerging Market Bonds

US Treasury yields fell across the board in June, with the ten-year yield hitting its lowest level since early March despite strong labour market data in the US. Lower benchmark rates, combined with credit spreads grinding marginally tighter, contributed to another strong month for our EM bond portfolio. It had a return of 1% in June, taking year-to-date performance to 2.7%.

Oil prices maintained their strong rally, with *Brent Crude* up 8.5% in the month. Despite new Covid-19 related restrictions in parts of Asia, the market has been buoyed by demand from the US, particularly as the summer driving season has kicked off and gasoline inventories have hit a five-year low. This in turn led to another strong month for our energy credits, with *YPF* and *Tullow up* 7% and 4.9% respectively. Macroeconomic conditions in Argentina are gradually improving, and there is a growing consensus that the government will be able to strike a deal with the IMF to reschedule debt payments, which should act as a tailwind for Argentinian assets.

During the month we added one new credit to our portfolio, *Kosmos Energy*. Kosmos is a US-based upstream oil & gas business with a diversified asset base in Africa and the Gulf of Mexico. The business has an attractive credit profile, with growing production, an active hedging programme and a very comfortable maturity profile. Given the current high oil price, combined with our positive outlook for the remainder of the year, the company should generate significant cash flow, leading to strong deleveraging of its balance sheet over the next six months. The 2026 notes which we bought have an attractive 7.8% yield to worst.

With the first half of the year now behind us, we are pleased with the strategy's year-to-date performance of 2.7%, which is very much in line with our annual target of 4% to 6%. We continue to view EM corporate debt as one of the few asset classes where it is possible to still obtain attractive yields, and given our portfolio's short duration of 3.1 years and current yield of 6.5%, we feel well positioned for the potential increase in rates going into the second half of the year.

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