Commentary

PATIENCE REQUIRED

Transitions are difficult periods. By definition, they follow periods of clear direction, they can last a long time, and their outcomes are uncertain. Some of the most impactful transitions unfolding today are the climate crisis and the transition to a carbon-free economy, the political and economic rise of China and the change from a US-dominated order to a multi-polar world, and digital transformation and the shift from offline to online. These long-term transitions represent global challenges that offer risks and opportunities for many years.

What makes the current period so challenging is that we are also at a critical juncture for the Covid-19 pandemic and the uncertainty about vaccines and immunity. The indications are that we are in a transition from the acute to the chronic phase of the pandemic. Scientific research and innovation have delivered tests, vaccines and other therapeutics at record speed, we are better prepared to manage it, and closer than ever to overcoming it. The global economy has weathered the crisis, many companies have delivered strong results, and markets are at all-time highs.

Yet the pandemic itself is stubbornly persistent and we will have to deal with the reality of it for years to come. The measures we have taken to overcome it will have lasting impact too, short-term in terms of the significant shortages we are seeing in the supply of labour, goods and trade, and long-term in terms of the debt that governments have accumulated in supporting employment and economies through the crisis.

That is why, as we assess the outlook and the risks and opportunities we face, we would do well to recall that, beyond our usual diligence and resolve, patience is required to take the right decisions.

Our Investment Insight this month links directly to one of these major transitions. Among the best-known Chinese sayings is one attributed to Confucius: "With time and patience, the mulberry leaf becomes a silk gown." Earlier this year, the Chinese government adopted its 14th five-year plan. Its objective is to achieve 'common prosperity' by addressing three key development gaps: the regional gap, the urban/rural gap and the income gap. One of its biggest goals is to double the number of middle-class individuals from 400 million to 800 million by 2030. Since then, the government has announced a number of measures to action its plan. As a result of one of these announcements, about changes to taxation affecting primarily higher income individuals, companies in luxury, spirits and other businesses with significant exposure to high-income Chinese consumers have come under pressure due to concerns about their future propensity to consume.

Coco Chanel once said that "Luxury is a necessity that begins where necessity ends." China has lifted 800 million people out of poverty, the greatest example of poverty alleviation in modern history. It has not done this overnight and it has not been easy. There have been mistakes, dilemmas and trade-offs along the way. But over the past forty years, China has also had effective leadership, long-term vision, strategic patience and resilience. It has learned from many of the difficult challenges of the past and has not been afraid to experiment, adjust and learn.

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The link to the bigger geopolitical transition to a multi-polar world lies in the varied experiences of economies in the East and West, North and South. They show that there is no single path or blueprint to prosperity. This is both humbling and reassuring. Different countries have embarked on journeys that are far from linear or straightforward in their own ways, confronting challenges and tensions that illustrate how complex and contested pathways of change can be. There are no easy answers. But the risk and the promise lie precisely in how different countries navigate through these complexities, and how they address the expectations, needs and demands of their populations.

We do not underestimate these issues. But the overall incentives should be aligned because 'common prosperity' is a goal for all countries that requires peaceful relations between states, functioning markets, rule of law and free trade among the necessary conditions for its achievement.

It is important to base investment decisions on the facts. As we outline in the Investment Insight by our senior analyst Zhixin Shu, the goals detailed in the new five-year plan adopted in March of this year are not so different from those of many Western countries that are grappling with similar issues. To us the surprise is not so much in the policies as in the market reaction.

The middle class will be one of the most important beneficiaries of the government's policy. That is why we believe that our investment thesis on the consumer and luxury companies we invest in remains intact. As their number doubles to 800 million and they put necessity behind them, middle class demand for the necessity of luxury will be a tailwind. Achieving the goal of common prosperity and creating the biggest group of mass-affluent consumers will be good for China, and we hope that it will be mirrored by similar successes in other countries, including our own. You can read our insight with details on the Chinese goals and policies in full by following the link here or clicking on the attachment.

We will have to be patient as we go through these transitions through the end of this year and in the years to come. While the impact of the pandemic remains the greatest uncertainty, we are hopeful that vaccination and immunity as a result of infection is sufficiently weakening the links between infection, hospitalization and serious outcomes to allow economic activity to resume as it has.

With the strong economic recovery, it is only to be expected that the reduced supply caused by the measures to control the pandemic cannot cope with the resurgent demand. The pandemic has disrupted supply chains and led to shortages and bottlenecks that will take time and effort to overcome. However, we think that inflation caused by this strong demand for limited supply will be temporary. As the supply of labour and of goods increases, it will reinforce, not threaten, the strong economic recovery we are experiencing. Governments and central banks in the US and in Europe are aligned in their statements that they will follow facts and act cautiously in the face of the continued uncertainty.

Earlier this year, we were saying that we will have to deal with the inevitable slowdown after the recovery, whereas now it appears we are back to concerns about the recovery itself. Our outlook remains positive given the quality and value of our investments and the results they have delivered. Long-term investment requires patience and we are confident that it will pay off.

World Stars Global Equities

Our World Stars Global Equities Fund closed August up 2.0%, bringing performance year to date to 18.7% (both in US dollar terms).

Performance was led by *Alcon*, the largest eye-care devices company in the world. Its shares rose 13.1% for the month, driven by strong Q2 results, which reflected market share gains, sales growth acceleration and improving operating margins. All business categories recorded revenues above 2019's pre-pandemic levels, with each division coming ahead of expectations. Surgical division sales were 14% above 2019's pre-pandemic levels, driven by a recovery in surgical procedures as well as by the adoption of new products in AT-IOLs (Vivity and PanOptix). Vision Care reported revenues which are 8% above pre-pandemic levels, with contact lenses recording growth in all product categories. Alongside these strong results, management raised their guidance for full-year 2021 sales and EPS respectively.

Within the information technology sector *Salesforce,* closed the month up 9.6% after reporting very solid Q2 results with 23% growth in revenues, ahead of market expectations. Growth came across the board, with the cloud, services and marketing divisions all posting strong growth. Management raised guidance for revenues and operating margins for the full year, as well as an increase to revenue contribution from the acquisition of Slack. Notably, management highlighted the improved demand environment created by the Covid-induced acceleration of digital transformation. Tech giant *Alphabet* continued its strong performance, with shares rising 7.6% in August and 66% year to date. Online advertising growth showed no signals of cooling off, with non-retail advertising spend now growing more than retail, due in part to increased spending from B2B companies and those set to benefit from the reopening of the economy. Creative and digital media software solutions provider *Adobe* was also up 6.8% for August, with the company announcing the acquisition of the cloud video collaboration company Frame.io for USD 1.3 billion. Frame.io is a collaboration application for the management of video projects and workflows, and operates similarly to Workfront, which Adobe acquired last year. Video is becoming the primary content platform for communication, and this acquisition can further separate Adobe from the competition by broadening its product suite.

Diversified industrials company *Eaton* also performed strongly and is up 6.9%, with its latest quarterly results showing organic growth of 27%, highlighting the strength of the underlying economic recovery. The company reported strong growth in all business segments alongside margin improvements, with the key feature being strength in its electrical business as its backlog grew by 43% and 50%, respectively, in the Americas and globally. The company also closed the sale of its hydraulics business to Danfoss for USD 3.3 billion, an important milestone in its portfolio-transformation process. The sale transforms the company into a focused play on the structurally attractive electrical and aerospace verticals, and it is set to benefit from the transition to a low-carbon, digitalised economy.

On the weaker side during the month, in addition to *LVMH*, payments companies *Visa* and *Mastercard* recorded losses over the month, with the rise in Covid-19 cases impacting near-term travel and spending plans. We believe that with the ongoing global secular shift towards card-based and electronic payments, both companies have significant long-term runways of growth ahead of them.

Multi-Asset Income

August was another strong month, despite some bouts of volatility mostly in equities. The multi-asset income strategy increased by 1.8% from the previous month and is now up 10.7%

since the start of the year (both in US dollar terms). Equities and bonds contributed almost evenly to the performance this month, and are now respectively up 2.2% (21.5% for the year) and 2.3% (7.3% for the year).

Equities moved higher due to strong earnings growth, while credit benefited from a combination of strong earnings and cash flow generation that strengthened balance sheets. Non-correlated funds have been more subdued this year as trade finance funds faced supply chain issues, but at least now they are showing a slightly positive return of 0.2% for the year.

Increased volatility for equities was caused in part by the somewhat contradictory concerns that the Covid-19 Delta variant could dent global economic recovery and that the US Federal Reserve could start reducing its monetary support earlier than expected despite its repeated statements to the contrary. These uncertainties led to record buying of US treasuries as 'safe haven' and there is some evidence that investors have reduced their risk exposure.

In the face of this short-term uncertainty and the possibility of increased volatility, we believe that our positioning, firmly anchored in the long-term and based on the selection of individual securities, is the best hedge against a change in investor sentiment. Our investments' cash generation is strong, and although we expect growth to slow from its extraordinarily high levels due to the economic recovery, our portfolio is well positioned to weather what we see as a transition period.

Emerging Market Bonds

Our EM bond portfolio had a strong month, gaining 1.2% and bringing year-to-date performance to 3.9% (both in US dollar terms). Despite an increase in the US ten-year treasury yield and the general lack of liquidity in the market over the month of August, fixed income assets were supported by dovish MPC minutes that suggested that the US Federal Reserve is likely to delay the start of tapering its asset purchases and will maintain its expansive monetary policy in the near term.

The top contributor to performance was *YPF*, the state-owned Argentinian energy company, which was up 11% over the month. This was driven in part by a very strong set of second quarter numbers, but also by signs that President Alberto Fernández's left-leaning coalition was losing ground ahead of the mid-term elections which are scheduled for November this year. Argentina's major opposition parties would likely fight against policies advocated by the current government, which has used unorthodox policies such as foreign exchange restrictions to try to trigger economic growth.

Grupo Posadas, a leading Mexican hotel operator, announced that it had reached an agreement on the terms of a restructuring of its debt following the disruption to the hotel sector caused by the pandemic. The favourable terms of the proposal included maturity extension, additional security, coupon step-up and, importantly, no haircut. This should allow the company time to gradually recover from the effects of Covid-19 as vaccination rates improve and government restrictions are lifted. Now that there is greater visibility on the way forward we have added the company's bonds to our portfolio, and the bonds have reacted positively to the news, returning 6.2% since our purchase.

Crude oil prices have been volatile, briefly dropping to their lowest level since May before partially rebounding again as worries about the outlook for fuel demand caused by rising Covid-19 cases coincided with OPEC's decision to increase oil output. As a result, our

African energy corporates, *Kosmos* and *Tullow*, were the largest detractors this month, down 1.7% and 0.4% respectively.

With second quarter results now behind us we are very pleased with the positive momentum we have seen across our holdings, given the strong underlying fundamentals of our companies. We therefore feel well placed to deliver on our annualised return target of 4–6% for the full year.

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