Market Commentary

STRONG FUNDAMENTALS

As we wrote back in September, we are amidst an extraordinary transition period, as the global economy attempts to enter a post Covid-19 world. This period is characterised by strong economy recovery, voracious consumer demand for goods and services, resurgent industrial production and resource demand and extensive corporate investment in capacity and capabilities, but also by inherent volatility in the underlying economic data and capital markets.

Inflation remains a key concern for the markets. The recent 6.2% increase in the US Consumer Price Index, the highest reading in 30 years reignited fears of the effects of rapid and unpredictable price pressures on the economy. And the US is not unique, as inflation numbers edge up across the global economy, including Germany, the UK, Eastern Europe and elsewhere. Some of these increases reflect a normalisation of pricing for goods and services impacted by the pandemic, for example airfares and energy. But in recent months price increases have affected wider segments of the economy, namely logistics, the automotive industry, commodities and labour.

It is important to recall why these increases are happening. The global economy has faced an unprecedented rate of disruptive forces over the last three years, even before the pandemic began. Trade issues between the US and China resulted in significant disruption to global trade flows and supply chains. This was followed by the shutdown in economic activity in the first half of 2020, followed by an unexpectedly rapid recovery and a shift in disposable spending from services to products.

It is therefore no surprise that ports, semiconductor production facilities and energy producers have been struggling to fully resume activities. We see companies across the industrial spectrum working hard to secure the required investments, while addressing a myriad of challenges. Similarly, we have seen a contraction in labour force participation and shortages in key logistical sectors, such as road haulage and warehousing.

To some extent, the current changes in the labour market can be attributed to baby boomers who have reassessed their life priorities post pandemic and left the labour market, or people choosing professions with better working conditions. They are also related to complex social factors including access to childcare or general uncertainty regarding the evolution of the pandemic. Ultimately, we believe these issues will prove transitory and the global economy will readjust to more normalised levels of activity.

The question is how companies will cope and whether we are seeing any evidence of demand destruction. Only two months ago as the Delta variant raged across the US affecting job creation and raising concerns about the sustainability and pace of economic activity. Fortunately, these concerns proved to be short lived, as the US economy has continued to grow and generate jobs.

Consumers have continued to spend on discretionary purchases such as drinks, cosmetics and luxury goods. As a consequence, businesses have increased their capital expenditure as economic activity gathers pace. These investments in the infrastructure of tomorrow will be important drivers of growth for the years to come. They will enable a transition to a low

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carbon economy, improve energy generation and transmission, and increase factory automation among many other benefits. Ongoing digital transformation will cause businesses to continue to spend heavily to digitalise and to improve CRM systems, online marketing and e-commerce capabilities.

Recent US corporate results have been strong. By the middle of the month, S&P companies reported 18.8% revenue growth and 43.7% earnings growth on average. Although margin delivery has been good in aggregate, distribution has been uneven across the reporting universe. Companies with stronger pricing power or lower exposure to raw material or labour cost inflation have been better placed to withstand current inflationary pressures.

Our holdings include many of those companies. Their pricing power and proven ability to adjust their cost base and size has meant that they have been able to pull all the levers at their disposal and to delivering higher profitability as we expected. As we look to next year, we expect this differentiation in performance to continue, as easy gains from economic recovery/value stocks subside and markets shifts back to long-term secular growth, differentiated business models and strong track records of execution. This is a positive environment for our investment approach.

One of the key areas we have focused on historically has been on the digital transformation space, that is companies that are driving the shift of the global economy towards a digital, online, asset light model. We often refer to companies like Alphabet, Amazon, Adobe or Facebook in that context. However, such opportunities are not limited to developed or indeed equity markets. In their investment insight "Digital Transformation in Emerging Markets: Opportunities for Credit Investors in African Digital Infrastructure", Charles Gélinet and Devin Cameron identify opportunities arising in emerging markets from the accelerated digitalisation of services, transactions and payments in local economies. They find that in some cases emerging markets are adopting digital technology far more quickly than the developed countries. and discuss how to take advantage of them from a credit investor's perspective.

To illustrate, 16 of the top 30 nations in terms of revenue from digital services as a share of GDP, are from the emerging world. In regions where people have limited access to a bank, doctor, shop or school they are likely to turn to digital access points instead. For customers, digital technology means greater access to products and services at a more competitive pricing level. For businesses it means new channels to reach existing customers, without needing to invest in costly networks of physical infrastructure.

There are a variety of ways for investors to take advantage of this digitalization. One option is by investing in bonds of local mobile network operators (MNOs) that benefit from the steady user growth and cash flows generated from their base businesses, as well as from rapidly increasing data usage and high growth ancillary services such as fintech and mobile money, like MTN, the largest MNO in Africa. Another is through communication infrastructure providers such as independent mobile tower companies or fibre optic network providers that provide the necessary backbone to MNOs.

World Stars Global Equities

The World Stars Global Equities Fund closed October up 4.8%, driving year-to-date performance up to 17.7% (both in US dollar terms).

This was driven by strong performance across our holdings on the back of solid third quarter results that underlined the robust top-line momentum for our companies, as well as their ability to cope with the current cost and supply chain pressures. Our technology holdings made up for their September losses after posting solid third quarter results, showcasing strength across end markets. *Alphabet* was up 11.3% during October with revenues coming above consensus, driven by strength in advertising, which grew 44% on the back of momentum in the retail, entertainment, finance and travel verticals.

L'Oréal, the world's largest cosmetics company, was up 10.7% for the month, with sales for the quarter notably coming in 15% above pre-pandemic levels. Amidst robust demand for luxury and active cosmetics, new product introductions and an expanded online presence continued to drive share gains.

Thermo Fisher Scientific, the world's largest life sciences company, closed the month 10.8% higher. The company reported a solid set of results, with Covid-19 testing revenues reporting above expectations and the recovery in its core business gaining momentum. Importantly, the company has been able to leverage the Covid-19 proceeds to invest in R&D, capital expenditure and acquisitions that have solidified its position as the largest company in the industry, underpinning earnings for the years ahead.

On the weaker side during the month was the payments sector. Market leaders *Visa* and *Mastercard* both reported solid quarterly results, with payments continuing to benefit from the switch to a cashless society. These gains were achieved despite stocks being hit by the still muted cross-border travel spend, where volumes remain at 30–40% below pre-pandemic levels. We believe that these companies are advantageously positioned as we look to 2022, with travel activity set to continue normalising as higher vaccination levels and new therapy introductions set the stage for a post-Covid world.

Multi-Asset Income

September's volatile and negative markets were followed by strong performance in October, with our strategy recovering almost all the lost ground and finishing 2.1% up for the month in US dollar terms (meaning it is now up 10% since the start of the year).

Equities were the main driver, ending up by an extraordinary 5.4% (up 20.7% year to date). Our fixed income portfolio was stable for the month (at 0% in US dollar terms, but up 6.6% for the year). The non-correlated funds had a slightly positive contribution of 0.9% in October, taking the performance year to date to a slight negative of 0.7%.

Markets were under pressure from the prospect of the US Federal Reserve withdrawing monetary support by reducing its bond-buying programme and earlier-than-expected interest rate rises. At the same time, equity markets found strong support from a very solid third quarter earnings season globally. It showed that many large companies were able to offset the negative effects of various bottlenecks and supply chain issues and deliver strong revenue and profit growth.

The performance of our credit portfolio, whose earnings releases started later, was more mixed as bond yields increased globally and local political issues in Turkey and Argentina put pressure on some of our holdings, despite the strong operating performance of those businesses.

As we approach the end of the year, we will have greater clarity on the timing of withdrawal of monetary support and of possible interest rate rises. We will also continue to see the effects of rising prices and ongoing supply chain disruption on companies' earnings for the market as a whole. However, we are comfortable with our balanced portfolio positioning and are unlikely to make any changes.

Emerging Market Bonds

Bond yields rose broadly as central banks indicated the likelihood of tightening monetary policy in light of rising inflationary pressures. Despite this, our Emerging Market Bonds strategy was up 0.2% in October, taking the year-to-date performance to 3.5%.

The top performer in the portfolio was *TV Azteca*, the Mexican TV broadcaster, which announced strong Q3 results as the gradual recovery of economic activity strengthened the advertising market in Mexico. Combined with management's efforts to improve efficiencies in content production, this resulted in a solid rebound in profitability.

We saw some weakness in both Brazilian and Turkish credits. In Brazil this was due to elevated economic policy uncertainty and the additional erosion of an already limited fiscal position, with President Bolsonaro attempting to improve public opinion ahead of the Brazilian general elections next year. In Turkey, President Erdogan's preference for unorthodox monetary policy saw the central bank delivering a larger-than-expected cut in interest rates, pushing real rates further into negative territory, which caused the lira to depreciate and put pressure on Turkish assets.

We will be closely monitoring third quarter results for signs of economic weakness, supply chain disruption or inflationary pressures which could cause margin pressure over the next few quarters. However, we are confident that our companies have both the fundamental strength to weather these pressures over the short term, and the pricing power to pass through much of this situation over the medium to long-term.

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The Value of Long-Term Investing

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