

## Market Commentary

### HOPE, CONFIDENCE AND CONVICTION

*“Buffet buying now in the face of all the uncertainty – the geopolitical and economy and interest rate uncertainty – is a real vote of confidence in the US and global economy. He is telling us that he believes there is value and that you can buy companies that will do well and will deliver more value than cash”*

Our Chief Investment Officer, Christopher Rossbach, had an opportunity to comment on Warren Buffett’s recent purchases for Berkshire Hathaway in this weekend’s [Financial Times](#). We do not always buy the same companies but we agree with him that there is great value to be had from mispriced stocks.

The Russia/Ukraine conflict continues at a terrible human cost. We believe it is significant that Russian gas is still flowing through Ukraine to Europe and being paid for, that Russian oil is being sold, most likely to China, India and other places and being paid for, and that the US government has allowed Russia to route USD interest payments on bonds through JP Morgan and Citibank to avoid default. This is all despite the conflict and the sanctions, and in particular the ban from SWIFT. It makes us hopeful that basic political and economic relations still exist and that there is a possibility that the conflict can be settled.

We started the year with the prospects of a strong global economic outlook, a short-term recovery from the Covid pandemic and the beginning of a multi-year economic cycle, led by investment in public and private capital infrastructure.

The pandemic set back this recovery by two years and now the Russia/Ukraine conflict has thrown it into disarray. The main impact is on commodities like oil and gas, fertiliser, grain, and some metals. We believe that the most impactful sanctions could be reversed quickly if there were a settlement. On the other hand, the suspension of trading in Russia by US and European companies like Nestlé, which we commented on [last week](#), could last longer, and sanctions on oligarchs and politicians could be in place even longer still.

High headline inflation is being driven by energy prices and other short-term price increases related to supply constraints in inputs, labour, goods and services. Many of these are due to the pandemic and the Russia/Ukraine conflict, and should go back to more normal levels over time. China locking down Shanghai and Shenzhen is not helpful but is part of the reality that Covid is still an issue that will affect global supply chains. Millions of Ukrainians fleeing their country and looking to work will require significant government spending and provide much-needed labour supply in the EU and elsewhere. These are just two examples of the issues and the complex impacts they will have.

That is why we believe that inflation will moderate over the medium term and why we are not worried about rising inflation and higher interest rates over the long-term. We do not see how 30-year record levels of inflation could possibly become embedded within the global economy. The idea that central banks could lose control of inflation seems to us completely misplaced and it would be an error of judgement to make investment decisions for the next five or ten years based on the expectations that today’s inflation will continue.

As we discuss in detail in this month’s investment insight written by our equity investment team, we believe that there will be a significant realignment of global supply chains. It will

accelerate the partial reversal of globalisation that we have seen as a result of the pandemic, which exposed that global supply chains are too long, too far, too complex and too vulnerable.

We are already seeing nearshoring and diversification of suppliers. We expect that US and European companies will be buying less from Russia, and that Chinese, Indian and other companies will buy more. However, the demand and supply for commodities will not change. The global flows will be realigned, which will raise costs but will not ultimately disrupt the global economy.

You can read the Investment Insight by following the link [here](#) or by clicking on the attachment.

The key for this year will be the timing and outcome of the conflict. If there is a settlement we expect that markets should react positively and switch back quickly to the reality of strong global growth, inflation, higher interest rates and monetary tightening.

Corporate earnings for the first quarter of the year will provide important information about the impacts of higher prices and input costs on volumes and margins. Visibility is limited so far for the market as a whole but even if results are impacted we expect continued growth in earnings and cash flows.

This year's market correction means that many companies we hold are at very attractive prices, down 15-20% or more in some cases. Our companies have the growth and pricing power to do well and to offset any increases in their nominal and real discount rates to generate value over time. That is why any weakness is as much an opportunity for Warren Buffett as for us and any long-term investors.

## *World Stars Global Equities*

Our World Stars Global Equity strategy closed 4% lower in February in USD as the Russian invasion of Ukraine weighed heavily on the markets and caused commodity prices to rise sharply, adding to inflation concerns.

Despite this broad-based market sell-off, several holdings recorded a positive performance in the month.

*Raytheon Technologies*, the leading aerospace and defence company, closed the month 15% higher, benefiting from the company's significant defence exposure, especially in missile air-defence systems. As the situation in Ukraine continues to evolve, we are seeing increases in defence spending within Europe as geopolitical balances are reappraised, setting the stage for multi-year elevated demand.

Spirits producer *Pernod-Ricard*, owner of brands like Jameson, Martell, Absolut and Chivas Regal, was up 3.5% posting strong results with a 16.7% growth for the first half of the fiscal year 2022, as off-trade activity continues to normalise globally. *Nestle*, the world's largest food manufacturer, gained 2% as the company also reported stronger than expected results. Revenues grew 7.5% organically during 2021, including 7.2% in developed markets, the fastest growth for a decade.

Some of our holdings with higher price/earnings multiples performed less well during the month as the market rotated again from growth names into value as it did last year. We expect that such moves will prove short-term as companies deliver growth irrespective of any short-term macro volatility.

We also believe our holdings are well placed to meet the geopolitical and inflationary headwinds given their global diversified nature, strong operational capabilities and proven pricing power.

*Meta Platforms*, the parent company of Facebook, suffered a sharp correction of more than 30% following its latest earnings release, in which the company highlighted several short-term headwinds including Apple's iOS privacy changes and increased competition from TikTok. We believe these headwinds will prove transitory and, with the company's share price now trading at a significant discount compared to the broader market, investors have a clear buying opportunity. For a more detailed analysis of our thoughts, please read our Investment Insight last month, [Metaverse, Meta and Us: An Overreaction and An Opportunity](#).

### *Multi-Asset Income*

The month started reasonably as investors digested the volatile performance of January due to the increased hawkishness by the US Federal Reserve. However, Russia's invasion of Ukraine triggered investors' concerns, sharp rises in energy and commodity prices and a further market sell-off.

The Multi-Asset Income strategy finished the month down 3.2% in US dollar terms (now down 5.6% year to date). Equities contracted 3.9% on the month (down 9.7% year to date) and the fixed income portfolio, initially resilient, fell 4% in February (down 3.5% year to date) as a result of our Ukrainian exposure. The non-correlated funds were flat.

Investors' move to a 'risk-off mode' saw safe-haven assets rallying, led by US Treasuries, with the US Dollar strengthening against other currencies. Equities suffered from profit-taking of higher valued holdings and the rotation out of European companies due to the flight to safety, despite a strong earnings season and constructive guidance for 2022.

Three-quarters of the fixed income portfolio's loss was attributable to our Ukrainian holdings, *Kernel* and *MHP*, both leading agri-businesses in their respective fields (see Emerging Market Bond commentary for more detail). There were no other substantial detractors to this part of the portfolio, which remained reasonably steady considering the environment. Increased volatility caused credit spreads in Europe to widen, but our holdings remained largely resilient. On a positive note, *YPF* benefited from the higher oil price and the prospect of strong cash generation, reduced leverage and a potential IMF deal for Argentina.

Looking ahead, risk assets face several challenges that will likely keep volatility higher than usual. Markets still face the uncertainty surrounding higher inflation with the added headwinds of higher commodity prices, especially energy, and further supply chain issues due to the Ukrainian conflict.

Before the latest geopolitical events, equity markets had come under pressure because of higher valuations, rising interest rates and higher yields. However, within the context of a still-recovering global economy, corporate earnings remained very supportive. However, higher input costs and possible hesitant consumer demand now put those earnings in doubt.

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*The Value of Long-Term Investing*

It is impossible to predict the outcome of current events. That said, we are reassured by the visibility provided by companies in our portfolio and expect earnings momentum to be sustained.

Our fixed income portfolio is well-positioned to deliver a strong return with a current yield of 8% and a yield to maturity above 12%. Most of our issuers have seen strong cash flow generation and rapid deleveraging over the past 12-months with positive guidance for a duration slightly in excess of three years.

Since the turn of the year, our asset allocation has remained largely unchanged, but we are continually watching for potential opportunities. There is a potential opportunity for reallocation to equities in light of their recent increased volatility. We have raised liquidity in the portfolio by selling issuers where our analysis concludes their prospects are less attractive. For example, we sold out of European issuers, *BWay* and *Balta*, whose bonds face coming under pressure from expected monetary tightening by the European Central Bank. A potential indirect impact from the Ukraine conflict, higher inflation and higher input prices could also weigh on their bonds.

Our central investment thesis is focused on quality and value to generate a solid cash yield with low volatility, and we are confident that our fundamental and disciplined investment approach will prevail.

## *Emerging Market Bonds*

The Russia-Ukraine conflict impacted risk assets globally. Our emerging market corporate debt portfolio was down 4.0% for the month in US dollar terms. It was one of the most difficult months for the asset class after the global financial crisis in 2008 and Covid-19 pandemic in 2020.

Our Ukrainian holdings *Kernel* (a diversified agriculture commodities business) and *MHP* (a poultry producer agro-industrial business), which represented 5% of the portfolio before the Russian invasion on 24 February, were the main detractors of performance, with bond prices declining c.50% over the month. The companies provided updates about a temporary suspension on exports and specific operations. However, they also affirmed that they had not suffered significant damage to critical infrastructure to date, benefiting from geographic dispersion of assets across the country, mostly located west of the Dnieper river.

Both holdings have strong liquidity positions (primarily held in US dollars abroad with international banks) and limited short term debt maturities, which means they can focus on any immediate operational challenges. With the moves in bond prices so far, we believe that there is limited further downside and that the recovery value over time will be greater than current valuations. These are very important businesses in Ukraine and, once the situation stabilises, the US and Europe are likely to provide significant support, which in turn should aid companies like *Kernel* and *MHP*. We do not have any direct exposure to Russian corporates and/or associated sanction risk.

Despite the implications of the conflict weighing on the global macro backdrop, contagion in emerging market corporate bond prices (ex-Russia and Ukraine) has been relatively contained, with corporate credit spreads widening on average 50 basis points during the month. Whilst Turkey has some of the closest trade links with Russia (exports represent 0.8% of GDP) and is also one of the largest net energy importers (5% of GDP) our Turkish

corporate holdings held up relatively well (down between -0.4 to -2.2%). This highlights their geographically diversified business models with a significant percentage of hard currency revenues and the strength of their balance sheets with average leverage of 1x debt/EBITDA.

Commodity prices, which were already supported by recovering global demand dynamics, faced supply constraints as the US and Europe looked to curb Russian exports. The latest earnings season of some of our oil and gas and mining companies in Africa and Latin America stressed that they will continue to be key beneficiaries of such dynamics, with elevated prices helping to generate significant free cash flow and balance sheet deleveraging.

Quarterly results across the rest of the portfolio illustrated mainly robust standalone corporate fundamentals. Given the recent increase in corporate credit spreads, our emerging market strategy now offers an attractive 10.3% yield to worst and 7.3% current yield with a relatively short duration of 3.4 years. The main headwind will be a scenario of slower global growth, higher inflation and tighter monetary conditions, which may lead to further risk aversion and subsequent widening of credit spreads. We will look to use such an opportunity to add positions selectively in quality corporates.

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