Market Commentary

VOLATILE TIMES; OPPORTUNITIES FOR LONG-TERM EQUITY RETURNS

March has been something of a curate's egg for investors with an increasing list of worries to focus on – whether it be Ukraine and its potential escalation, inflation, China's covid-related lockdowns, fears over errors by policy-makers, and the risks of recession whether caused by energy costs, broader inflation or over-enthusiastic monetary tightening. The correction in the US bond market has been one of the sharpest in many decades, from a yield of 1.7% on the US 10 year Treasury on 1st March to 2.5% on the 28th, and now to 2.8% today. This has reflected a swift change in mood from safe-haven status to one with greater emphasis on the Fed's US updated GDP forecast of 2.8% in 2022 (still well above the 20 year trend rate) and the prospect of 'higher for longer' inflation and the associated policy response.

At the same time, it is clear that many companies and industries are benefiting from a cyclical recovery in demand post-Covid and that for those with a global footprint, a manageable exposure to direct energy costs and (critically) with pricing power, the outlook for their profits and cash flows is still robust. This position across many global companies, with a particular boost for energy and mining stocks, and a recognition that equities are the largest and best asset class through which to gain insulation from inflation, combined to drive the MSCI World index up by 3% in USD in March and by over 10% from its low point in February.

Our own equity investments are focused in companies with minimal revenues in Russia and Ukraine, and powerful competitive positions in attractive growth industries. Public statements from these companies have naturally turned more cautious, a message that will be emphasized in the forthcoming Q1 results season, but we still expect good progress in revenues and earnings in 2022.

Last week our World Stars Global Equity Fund passed its three year anniversary as a UCITS fund and the strategy will have a ten year track record this October. These important milestones reflect a continuation of the Stern family's focus on investing in leading global stocks for over 60 years.

Our Investment Insight this month is focused on equity returns since 1928 using the Returns Triangle from Deutsches Aktieninstitut, which was originally based on the DAX index (top 40 stocks listed in Frankfurt), and which we have converted to show annualised equity returns based on the S&P 500 index. The analysis underlines the appeal of large-cap equities in a leading developed market as a powerful source of real returns for long-term investors.

Taking the entire duration since 1928, sub-divided into shorter investment periods, the average return over 5/10/15 and 20 years has been in the range of 10.2-10.8% CAGR in USD, including dividends and before costs. In a more recent example, an investor who purchased in January 2008 and endured a 37% fall in that year, would have received a 9.1% CAGR return by holding onto those shares until December 2019, and 11% CAGR by December 2021. In other words, the longer you hold on to your equity investments, the more likely that poor performing years will be significantly offset by good years.

It is hard not to worry about the greatest current uncertainties, which we would class as a substantial escalation in Ukraine or significant errors by policymakers. But for investors with

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a long-time time horizon and an eye for high-quality investments listed on leading stock exchanges we believe this is a time to take advantage of volatility and the opportunities it presents.

World Stars Global Equities

The World Stars Global Equities strategy closed 2.6% higher in March, as markets recovered on hopes of a diplomatic route out of the Ukraine crisis and on a recognition that leading global stocks can offer good protection from inflation at levels similar to the current outlook over 2022-24 and in the absence of errors by policymakers. You can find the USD factsheet for our World Stars UCITS fund here.

Our holdings reflected the market recovery. *Nvidia*, the leading semiconductor chipmaker, closed the month 12% higher, following its capital markets day and news of product launches and software upgrades. We added Nvidia to the portfolio in February, taking advantage of price weakness. We believe it has a compelling product portfolio to capitalise on exciting new technology trends including gaming, data centres, AI and autonomous vehicles. At its capital markets day Nvidia raised its long-term forecast for its total addressable market to $1 trillion, reinforcing our conviction in its growth potential across these multiple large end markets. Meanwhile *Meta*, the parent company of Facebook, recovered 5% after its sharp fall in February. As we wrote in our February Insight, we believe that concerns around the competitive environment are overblown and do not reflect Meta's powerful market position, substantial cash flows and significant future growth prospects.

Within healthcare, life sciences market leader *Thermofisher* was up 9% for the month. The company has emerged from the pandemic with a structurally enhanced competitive position. It is reinvesting the cash flow from its $14 billion Covid-19 related revenues (over 2020-22) into increased R&D, new product development, add-on acquisitions and capacity expansion. In December it closed the $21 billion strategic acquisition of PPD, which adds a leading global clinical research business to Thermo's business in life sciences, diagnostics, analytics, biopharma services and laboratory products.

Essilor Luxottica, the leading ophthalmic lenses and eye-wear company recorded a 6% gain, in the anticipation of increased spend as we approach the upcoming summer season. The company is also benefiting from an enhanced e-commerce platform where it is posting significant growth across all geographies. The recent acquisition of Grandvision and its 7,000+ stores across 40 countries, has significantly expanded the company's footprint in key markets.

More broadly within the healthcare sector, we continue to see a recovery of several of our portfolio companies within the medical devices industry as hospitals begin to return to normal in the aftermath of the pandemic, with many previously postponed elective surgeries now going ahead.

On the weaker side, *Raytheon*, the leading aerospace and defence systems company, fell 4%. That said, Raytheon was still the portfolio's top performer during the first quarter of the year (+16%), supported by the recovery in commercial aerospace and now the broader ramifications of conflict in Europe. The company has significant exposure to defence systems including missile air defence and command and control capabilities, and we believe the planned increases in defence spending, particularly in Europe, present a clear opportunity.

Multi Asset Income

The first quarter closed on a stronger but volatile note with the strategy up 1.4% for March in US dollar terms. You can find the latest factsheet for our Multi-Asset RAIF fund here.

The portfolio enjoyed strong contributions in March from all asset classes with equities up 2% in US dollar terms (now down 8.8% since the start of the year), the credit portfolio showing a 1.2% positive return (a negative 3.4% return year-to-date) and non-correlated funds up 1.3% for the month (now up 0.5% this year). Year-to-date performance for the portfolio to the end of March stood at -5.1% in USD.

The month began with a flight to safety by investors with the 10-year US treasury yield shrinking to 1.7% (from 1.92% a week earlier) as the Ukraine conflict deteriorated. However, this proved short-lived. A more constructive narrative around a possible early resolution to the war combined with strong US economic data and more hawkish noises from the US Federal Reserve (with faster and more aggressive monetary tightening to keep inflation under control) triggered a very sharp adjustment to the entire yield curve. It was one of the largest corrections in the US bond market's history.

In the absence of earnings specific news, equities were somewhat under the cap of growing concerns regarding global economic growth. Key drivers were inflationary pressures, the potential impact of higher input prices and subsiding consumer confidence. However, some equities benefited from bargain hunting following substantial price corrections so far this year. Digital companies that attracted investors' interest included Nvidia and *American Tower*. Healthcare companies were also in favour led by *Roche* and ThermoFisher.

The credit portfolio's performance was mostly driven by idiosyncratic stories (our exposure to the Ukraine conflict through our holdings in *Kernel* and *MHP*, see Emerging Market Bond commentary below) as well as our exposure to the energy sector, which benefited from relatively high sustained oil prices with *YPF* and *Tullow* showing solid positive returns. The Turkish Central Bank kept interest rates unchanged at 14% despite inflation rising to 55%. We have taken advantage of some weaknesses in selected Turkish bonds (*Turkcell* and *Tupras*) to reinforce existing positions in those high-quality issuers. Overall, the asset class has demonstrated its limited sensitivity to interest rate movements and so far credit spreads have behaved well, underlying the continued constructive economic environment.

Markets are increasingly concerned about the possibility of a recession in the US (following the inversion of the yield curve) and in Europe (due to the high cost of energy and the impact of the Ukrainian conflict on consumer sentiment) next year. On balance, we believe that risks have increased from the previous month due to several reasons. First, the potential for a protracted conflict in Ukraine; second, inflation remaining higher for longer; third, the impact of higher prices on corporates' input costs and consumer demand; and finally, the increased probability of central banks' policy errors.

However, despite this more cautious stance, we remain confident in our asset allocation and securities selection. We will use any opportunity to further improve the overall quality of our portfolio and we are confident that we are currently well-positioned to deliver on both cash generation and capital gains over the long term.

Emerging Market Bonds

Our emerging market corporate debt portfolio was up 0.4% for the month in US dollar terms, recovering some of the losses from earlier in the year caused by rising interest rates and elevated geopolitical risks centred on the Russia-Ukraine conflict. You can find the latest factsheet here.

While US interest rates continued their upward trajectory in March (10-year note widening 50bps to 2.3%), credit spreads followed suit initially before tightening to levels last seen pre-invasion as investors saw attractive buying opportunities which triggered inflows into the asset class. The conflict in Ukraine continued to be the focus of attention albeit with an outcome of events still difficult to predict. We saw some recovery in bond prices after the initial selling as our investee companies provided operational updates.

Specifically, MHP (an agri-industrial business focused on poultry production) verified that 95% of their land is still under Ukrainian control and they have already restarted exports, resorting to trucks as seaborne routes via the Black Sea ports in Ukraine remain blocked. Meanwhile, Kernel (diversified agri-commodities business) confirmed no critical infrastructure had suffered significant damage and they were also exploring alternative export channels. Given current events, both companies gained lender support to postpone forthcoming debt obligations as they look to preserve liquidity and channel cash flow toward the immediate operational requirements of the business to protect their longer-term viability.

Elsewhere our oil and gas companies across Africa and Latin America were the top performers during the month, as crude prices briefly touched $140/barrel, a level last seen in 2008, as sanctions imposed on Russia elevated concerns of tighter oil markets. *Tullow Oil's* earnings highlighted the company's significant free cash flow generation on the back of higher oil prices and lower costs with its shift from riskier exploration towards producing assets, which has subsequently supported significant balance sheet deleveraging. Elsewhere, YPF showed signs of an operational turnaround with their investment plan starting to reverse previous trends of declining oil production, which combined with better-realised prices, resulted in leverage reducing below 2x – a level management has now committed to maintaining going forward.

We continue to look for opportunities to diversify our portfolio. In March, we used the market volatility to add *Braskem*, the leading petrochemical business in Latin America and a major player internationally. The company has benefited from strong demand drivers for its chemicals, high prices and elevated petrochemical spreads. Such dynamics have helped it generate more than $2bn free cash flow, reduce net leverage below 1x and recently regain its investment grade credit rating.

Today, our emerging market corporate bond strategy offers an attractive 10.3% yield to worst and 7.4% current yield with a relatively short duration of 3.4 years. Key headwinds will be slower global growth, higher inflation and tighter monetary conditions, which may lead to some risk aversion, albeit robust standalone corporate fundamentals will stand the portfolio in good stead. From a technical perspective, given the significant recent tightening in credit spreads, companies are likely to return to the primary bond issuance market, which may put some pressure on yields given supply/demand dynamics. We will look to use such an opportunity to add positions selectively in quality corporates.

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The Value of Long-Term Investing