Investment Commentary

KEEPING OUR HEADS

> "If you can keep your head when all about you
>
> Are losing theirs…"
>
> *Rudyard Kipling*

Rudyard Kipling's poem "If" has a lot to teach us about how to approach the current market volatility and uncertainty.

Most important is to maintain a level head and keep your composure in the face of adversity. You have to have confidence in yourself and your abilities, "to trust yourself when others doubt you", even in the face of scepticism or opposition. You have to do the hard work necessary to achieve your goals, to be patient and disciplined, and to resist the urge to make impulsive decisions because of fear or uncertainty.

We look for quality and value in our investments but ultimately it is about resilience. History shows that economies and societies are resilient. There have been many periods of political and economic turmoil, but societies and economies have proven to be remarkably resilient, adapting and rebounding over time.

We have been busy doing the hard fundamental work on our companies, their industries and the drivers of their revenues, costs, profitability and returns.

That is why we are not surprised by how strongly our World Stars Global Equity portfolio has performed during the first quarter of this year. We did the work, we did not lose our heads, our companies were resilient and their quality prevailed.

It is how we got through the challenges of last year and had the conviction to take advantage of the volatility and buy more shares of our companies at lower prices. It is also why we are confident in our ability to deliver value in the future.

In January, Zhixin Shu wrote about the reopening of China. Based on her recent experience in Beijing she said that we thought luxury goods and consumer discretionary companies would benefit from resurging consumption and an excess savings boom. This week a front page article of the *Financial Times* was "China's economy rebounds more than expected after Covid reopening" and the value of our shares in LVMH and L'Oréal hit all-time highs after reporting strong Q1 results.

In March, Giles Tulloch published our take on the future of digital advertising. He argued that it is wrong to focus merely on the potential for increased online advertising penetration of a total available market that is cyclical and grows at or above GDP. Instead a company that can increase its online sales through digital advertising has totally different economics from those sales. It can close retail outlets, improve efficiency in its supply chain and distribution, cut costs and lower its capital intensity. That is why we think the market has significant growth ahead. We also see AI as an opportunity for many companies as the need for computing capacity, cloud computing and other resources will grow exponentially. We maintained our position in Meta last year and increased our position in Nvidia, not far off its lows of November. Nvidia and Meta are the first and second top performers of the S&P 500 this year, up 89% and 71%, and coincidentally both up 140% from their lows last year.

4 Carlton Gardens
London SW1Y 5AA
United Kingdom
Tel: +44 20 3478 1800

1 Rockfeller Plaza
New York, 10020
United States of America
Tel: +1 212 219 0200

Gartenstrasse 10
8002 Zurich
Switzerland
Tel: +41 44 552 80 70

2, Sir Augustus, Bartolo Street
Ta' Xbiex XBX1091
Malta
Tel: +356 2034 5006

J. Stern & Co.
www.jsternco.com
info@jsternco.com

Part of it is what we do not own. Our investment insight this month is a short piece entitled 'The Trouble with Investing in Bank Stocks'. It posits that last month's collapse of Silicon Valley Bank and Credit Suisse may have been the first central bank induced banking crisis and emphasizes why we do not buy shares in banks. The investment insight also has a link to a webinar we held last month about the impact of the banking crisis on our portfolios. You can read it by clicking on the link here or on the attachment.

One of our oft-quoted sayings by Charlie Munger, Warren Buffett's business partner in Berkshire Hathaway, is that "micro is what we do and macro is what we put up with." Our macro-economic outlook is based on the same fundamental principles as our investment approach. In the US, the most important driver for the world economy and for asset prices, economic growth continues and Fed policy is as data driven as always. If the US does what it does, and what it has done for close to 250 years, we will have global economic growth, in fits and starts of course, but sustained nonetheless. It implies that rates should stay at current levels or go higher, with volatility and uncertainty from political and economic risk, but driven by real economic growth and, if we see continued inflation, by real increases in wages and in spending power. All of this is part of a normal economy and something to look forward to, not to fear.

This is our core expectation. The macro-economic environment will remain challenging and volatile but we expect growth to continue, inflation to moderate and rates to stabilize. There will be winners and losers among companies but we expect the quality companies we invest in, with growth and innovation, pricing power and economies of scale, to have resilient earnings.

Valuations for these companies have reset and are attractive despite the rebound, and entirely aligned with the inflation and interest rate environment. Triumph and disaster may be two imposters as Kipling says, but quality and value will prevail.

Please join us for our World Stars Global Equity investment update on 25th April. The call is for existing and potential investors in the World Stars. It will cover our recent performance, our views on the outlook and a focus on the ability of our companies to deliver profitable growth despite the current inflationary pressures.

If you would like to join, you can register using the link below:
https://us02web.zoom.us/webinar/register/WN_ks-JuJ-YQNyrHbRZTorxBw

World Stars Global Equity

March was a strong month for our World Stars Global Equity strategy. It weathered the concerns about banking crisis in the US and Europe, closing up 6.9% for the month and up 12.1% year-to-date, both in US dollar terms. You can find our latest factsheet here.

Performance was led by our technology and digital companies, driven by ongoing cost-efficiency programme announcements and better-than-expected revenue growth. The best performer was enterprise software provider *Salesforce* up 22% during the month and 51% year to date. The company has now set an EBIT margin target of 27% in FY2024 and 30% by the end of FY2025, compared to 22.5% reported for FY2022. At the same time, Salesforce delivered 17% revenue growth on constant currency in the fourth quarter of FY2023,

alleviating concerns about the potential effect of a slowing macroeconomic backdrop on enterprise demand.

Nvidia, the semiconductor producer, was also among the leading performers during the month, up 20% in March and up 90% year-to-date at the end of March. Nvidia's recent results have stimulated renewed enthusiasm for the stock as new products have strong prospects of delivering revenue growth in datacentres and gaming, and the gross margins remain very robust (66% in the fourth quarter). The company is a key beneficiary of the rapid commercialisation of new AI-based solutions not only for text and speech but also for images, video and other types of data.

Meta, the owner of social platforms Facebook, Instagram and WhatsApp, was up 21% during the month, and was up 76% at month end. In March the company announced a second major round of job cuts, reducing the workforce by 11% after a 13% reduction announced in November last year. Combined with other cost-cutting measures, these actions have given real substance to Meta's claim that 2023 will be a 'year of efficiency'. The company is also leveraging its own internal AI capabilities to drive higher conversion rates on advertising.

Performance for our World Stars Global Equity strategy was also supported by robust trading from our companies in the cosmetics, spirits and luxury goods industries. This resilience came on the back of China's re-opening and ongoing consumer demand in the US and Europe, despite the recent elevated inflationary pressures.

Our portfolio has performed strongly in March and through the first quarter of the year, extending its gains from the low of the global equity sell-off in November last year. Markets have benefitted from increased confidence in the prospect of lower inflation through the second half of 2023 and the likelihood that interest rates may be close to a peak. Alongside this shift in the market paradigm, company specific news has been positive across most stocks, with market share gains, tight cost control and confident pricing supported by differentiated products and services.

Multi-Asset Income

March witnessed volatility especially in safe haven securities as markets shifted from risk-taking to risk-off and back during the month. The overall portfolio was up 1% for the month and is now up 4.1% year-to-date. You can find our latest factsheet here.

Equities were stronger returning 5.4% for the month and now up 10.9% year-to-date supported by lower US Treasury yields. The same should have been expected for the credit portfolio. However, credit spreads widened as a result of profit-taking due to concerns about a possible banking crisis and the health of the global economy. This part of the strategy retraced 1.7% over the month and is now up 0.9% year-to-date. Alternative funds were flat for the period, down 0.3%. All data is in US dollar terms.

Equity performance was driven by the strong performance of the technology sector. *Siemens Healthineers*, which had lagged this year despite solid guidance by management, rose 10% for the month. In contrast, *Schlumberger* slumped by 8% in line with the weaker oil price.

The performance of the fixed income portfolio was also affected by idiosyncratic stories (see Emerging Market debt commentary) including *Lumen Technologies* (-11%), which had

disappointing results and suffered from an expected credit rating downgrade. On the positive side, management decided to call some of the company's bonds, including our holding.

In our view markets are again re-assessing the current situation and switching their attention from 'higher interest rates for longer' to lower growth or recession due to the effect of global tightening on the banking sector, and more broadly on the global economy. Although recent economic data is supportive, including falling headline inflation, concerns over an economic downturn are growing, which is reflected in the pricing of safe haven US Treasuries, but not other asset classes.

We have increased our fixed-income exposure slightly taking advantage of attractive yields and bond prices. The portfolio is well-balanced and therefore we believe well-placed to withstand increased volatility while still generating attractive cash income.

Emerging Market Bonds

It was a volatile month for global risk assets with risk sentiment impacted by banking sector events in the US/Europe. Our Emerging Market Bonds strategy was down 0.4% for the month in US dollar terms. You can find our latest factsheet here.

The flight to safety saw the 10-year US Treasury yield tighten 0.5% to 3.5% and drove risk premia in emerging markets higher in sympathy. Credit spreads widened by a similar magnitude as the move in US Treasuries and now trade in line with their 20-year average.

Broader market volatility was offset by positive underlying corporate news. *Marfrig* (Brazil, consumer non-cyclical) was one of the top contributors to performance with the lifting of a temporary ban on beef exports to China, which had been related to an isolated atypical case of mad cow disease. Additionally, a recent resurgence of African swine fever affecting pork demand was seen as positive for beef demand going forward. During the quarter, the company also announced a bond buyback programme in line with its strategy of better capital allocation.

The main detractors of performance were *Total Play* (Mexico, communications) and *Wom* (Chile, communications). Their latest results highlighted strong revenues and EBITDA growth driven by increased demand for their services. Despite the strong operating metrics, both companies were still free cash flow negative (no excess cash to use) given high-growth capital expenditure related to network rollout and subscriber acquisition costs. This put some pressure on liquidity at a time when broader credit availability has contracted.

As banking stress headlines fade, we believe performance will be driven by macro conditions with the market refocusing on inflation and economic growth. Corporate credit fundamentals are starting from a strong base. However, tighter financial conditions could lead to lower growth over time and to credit metrics deteriorating.

Companies in our portfolio generally have comfortable debt maturity profiles that can mitigate any near-term refinancing risk. Valuations continue to look attractive both from a spread and yield perspective which should attract inflows to the asset class as sentiment improves. At the same time, the level of new issuance is running below medium-term trend, which provides a supportive technical backdrop. Such a setting is an opportunity for investors to lock in attractive income and total yields by selectively buying and holding bonds to maturity.

Today, our Emerging Market Bond strategy offers a 12.5% p.a. yield to maturity (in US dollar terms) with a relatively short duration of four years. This comprises a 7.8% p.a. income yield which provides a degree of visibility on future returns, as well as capital appreciation potential given the average bond price of 87 cents.

April 2023

J. Stern & Co. provides this document for information only. The information provided should not be relied upon as a recommendation to purchase any security or other financial instrument, nor should it be considered as a form of investment advice or solicitation to conduct investment business. Our services are only provided to clients, in certain jurisdictions and under a signed mandate. The views expressed from the date of publication are those of J. Stern & Co. and/or the actual author(s) and are subject to change without notice. Information within this document has been obtained from sources believed to be reliable at the date of publication, but no warranty of accuracy is given. The value of any investment can fall as well as rise; past performance is not a reliable indicator of future results; and returns may increase or decrease as a result of currency fluctuation.

J. Stern & Co. includes J. Stern & Co. LLP, Star Fund Managers LLP, J. Stern & Co (Switzerland) AG and/or J. Stern & Co. Limited. J. Stern & Co. LLP and Star Fund Managers LLP are both authorised and regulated by the Financial Conduct Authority, and where relevant, J. Stern & Co. LLP has approved it for distribution J. Stern & Co (Switzerland) AG is a member of Polyreg and is operating in accordance with Art. 74 para. 2 of the Swiss Federal Act on Financial Institutions. J. Stern & Co (Switzerland) AG is affiliated with the Ombudsman "Ombudsstelle für Finanzdienstleister", Bleicherweg 10, CH 8002 Zurich and J. Stern & Co. Limited is authorized and regulated by the Malta Financial Services Authority.

More information on J. Stern & Co. can be found at www.jsternco.com/legal, including our privacy notice, other regulatory disclosures and registered office information.

© J. Stern & Co.