Investment Commentary

THE LOLLAPALOOZA OF LONG-TERM INVESTING

The Berkshire Hathaway annual meeting hosted by Warren Buffett and Charlie Munger is often called the Woodstock of capitalism. We think of it more as the Lollapalooza of long-term investing.

We share their optimism and conviction that private enterprise and stable government can generate global growth, progress and prosperity. The globally leading companies that we invest in have delivered strongly this year despite all the issues and uncertainties we face.

Our CIO Christopher Rossbach has been going to Omaha for the past ten years to hear Warren and Charlie talk about business, investing and capital allocation, to get a snapshot of the US and global economy from Berkshire's many companies and to meet up with other investors from all over the world. Here are his key takeaways:

All good but bottlenecked

This year's meeting was a perfect metaphor for the bottlenecked post-pandemic global economy: the auditorium was packed, travel is back, people have decided to come to Omaha again from all over the world, in particular from China, and the 6am queues have never been longer. But by the time the traditional 'Berkshire movie' started, all 16,000 people had fit in, and the meeting was as informative, educational and fun as ever. See's Candies had a record day and ran out of peanut brittle leaving many disappointed, including us. It's the same with the global economy. Demand is strong but growth is held back because of bottlenecks. Inflation and interest rates are the biggest issues but the underlying cause is positive and we have to keep perspective.

A big day for Charlies

Another is that at 92 and 99, Warren and Charlie continue to astound with their insights into Berkshire's businesses and the broader economy. Not every decision they have made in the past year has been right and they admitted mistakes but their track record speaks for itself. Greg Abel and Ajit Jain, vice-chairs and heads of the industrial and insurance businesses, were on stage for the first half of the day but the second half with only Warren and Charlie was even more compelling.

The movie at the beginning was all about the inevitable succession and they joked that last Saturday was a big day for Charlies in London and Omaha (the Berkshire meeting date has been set for years and although the Royal family chose the same day for the coronation it was considerate enough to time it so we could watch it in the early morning queue). The day was a reminder of why people come to Omaha in person and how much Berkshire is about Warren and Charlie and the way they have built the company.

Industrial slowdown and increased investment

It was good to see Greg Abel taking a bigger role at the top table. Warren said clearly that Greg was going to be the next CEO and referred many of the questions about Berkshire's industrial businesses to him. Greg's more comprehensive answers showed that he has his own style. He is not as folksy as Buffett but he spoke about Burlington Northern, the railway, and Berkshire Hathaway Energy in a straightforward and knowledgeable way. Many of the industrial businesses are facing a temporary slowdown after the strong growth they had last year because of higher base effects, more cautious corporate investment, ongoing supply constraints and higher costs. They also have significant investment needs, like Burlington Northern in its track and smart rails technology, or Geico, the insurance company in upgrading its IT systems and telematics capabilities. We think Berkshire's companies are not alone in this need to reinvest in their business and we own a number of companies in our portfolios that will benefit from providing these products and services.

New opportunities for value creation

Warren speaks about the many benefits to companies from being a part of Berkshire's long-term business. His approach is to use the float generated by its insurance business and the excess cash earned by the wholly-owned businesses to invest in public equities or buy whole companies. Warren prides himself on being a long-term owner who does not care about short-term swings in numbers. He says that he lets management get on with their jobs and his calendar is mostly empty. CEOs say it is transformative not to have constant pressure from research analysts and shareholders expecting them to deliver every quarter and forcing them to make short-term decisions.

Greg Abel's background as a CEO and operator of businesses highlighted another opportunity for added value. Alicia Knapp, the CEO of BHE Renewables, talked about the steps it has taken to increase its exposure to renewables and highlighted its cooperation with Precision Castparts, another Berkshire company, to provide solar energy for a new plant in West Virginia. It is good to see Berkshire companies leveraging their resources across the business. There are tremendous opportunities for them to work together.

Charlie Munger says it all

Warren and Charlie got a question about their 100-year vision for Berkshire and Charlie nailed it. Talking about Benjamin Graham, the famous value investor, he said that Graham had been sheepish because much of the money he made came from a single growth stock, Geico, which is now a Berkshire company. "There was a lot of sort of lousy companies that were too cheap, and you can make a little money floating from one to another, but the big money he made was in one growth stock. Buying one undervalued great company is a very good thing, as Berkshire has found out again and again and again." That's all you need to know. Buy high-quality companies with strong competitive positions, solid growth prospects, good management and strong balance sheets and you will do very well.

Earlier this month Jeff Prestridge, Group Wealth and Personal Finance Editor of the Daily Mail and the Mail on Sunday and one of the most influential financial journalists in the UK, asked us about artificial intelligence and its impact on investment management. We said that we think that AI is only as reliable as the inputs, it cannot make judgements about the future and it will lead to index returns. No matter how you ask the question you will always get the same ideas back. An algorythm may be able to analyze data and to provide outputs based on patterns and correlations, whether it is AI or a systematic trading system, but there is no substitute for knowledge, judgment and consistency. We don't see a future where investment judgement is replaced by AI.

Charlie also had a great quote on artificial intelligence at the annual meeting. He said that he thinks old-fashioned intelligence works pretty well. We couldn't agree more and you can read Jeff's article on AI in the Mail on Sunday here.

With all the turbulence, conflict and uncertainty we face, this year's Berkshire Hathaway annual meeting reaffirmed the value of long-term, rational and moderate thinking and belief in the progress and prosperity that US and global business can achieve. It was a poignant day for Berkshire, its shareholders and for anyone who cares about long-term investing – and we have to hope that there will be more opportunities to come together in Omaha.

World Stars Global Equity

Our World Stars Global Equity strategy continued on its positive trajectory closing up 2.4% in April and up 14.8% year-to-date, both in US dollar terms. Performance was broad-based, with strong contributions from many of our holdings across sectors

Meta, the owner of Facebook and Instagram, once again led the way, with its shares up 13% during April (it is now up 100% year-to-date and 165% since its November 2022 lows). Its latest share price rise was fuelled by another solid earnings release with the company posting 6% revenue growth. This was as we expected but ahead of market expectations, alleviating concerns about a slowdown in digital advertising. The company continues to showcase strong user engagement with monthly average users reaching 3.8 billion across its family of platforms. Importantly, Meta is starting to reap the benefits of investing in AI capabilities, with improvements in advertising relevance and engagement fuelling its competitiveness.

Abbott Laboratories was up 10% as elective procedures continued to recover from the pandemic lows, a dynamic reflected in the strong performance of some of our other holdings within the sector.

Our holdings linked to the reopening of the Chinese economy and long-haul travel continued to power ahead. Of note, global luxury leader LVMH posted 17% organic sales growth, significantly outperforming market expectations as the local Chinese market rebounded and as high-end consumers in key developed markets remained resilient. A similar trend was echoed in the results of eyewear manufacturer EssilorLuxxotica, which posted 8.6% sales growth driven by strong demand for sunglasses ahead of the summer season.

On the weaker side, shares in semiconductor equipment manufacturer ASML fell, despite posting solid earnings results. New orders were lighter than expectations as customers paused after strong activity over the last few years. The company's EUR 39bn backlog stands at record levels, with the significant increases in semiconductor usage and urgency to re-shore manufacturing back to the US and Europe acting as powerful structural demand drivers.

Multi-Asset Income

Despite increasing evidence that restrictive monetary policy is slowing global growth, most risk assets performed constructively last month. Our Multi-Asset Income strategy generated a positive return up 0.9% in April and up 5.1% year-to-date, both in US dollar terms

Equities were buoyed by solid first quarter earnings, with most of our holdings announcing in-line or above expectations results and with encouraging outlooks for the remainder of the year. As a result, our equity portfolio was up 2% for the month and up 13.2% year-to-date. By contrast, there was a limited number of result releases by our fixed income holdings, which was up 0.9% for the month and (up 1.8% year-to-date. Our alternative income funds in the portfolio were only slightly up 0.4% for the month and down -1% year-to-date.

It was notable that Siemens Healthineers (+8.4%) continued to benefit from the positive outlook for this year and the relatively attractive valuation. Zoetis (+5.8%) has been strong going into the results with anticipation of strong underlying demand and the number of veterinary visits recovering.

Our fixed income portfolio was more mixed (see Emerging Market Bonds commentary below) with Level 3 (ex-Lumen Technology, +7.6%) recovering post the corporate action which put pressure on bond prices the previous month.

Since the start of the year, we have gradually reduced the strategy's equity exposure following the strong relative performance by the asset class. We are comfortable with the current asset allocation given the ongoing turmoil with US regional banks and the prospect of a volatile 'national debt ceiling' negotiation in the US potentially increasing the risk of renewed volatility. The tightening of financial conditions is also beginning to have an impact on global economic growth and a possible acceleration of a slowdown could put pressure on profit margins and earnings.

However, we are confident that the strong cash generation by our bond holdings will provide a solid volatility buffer in the current environment. With a current yield in the region of 8.5%, we believe that the mix of income and capital gains offered by the strategy is providing excellent visibility.

Emerging Market Bond

Our Emerging Market Bond strategy was up 0.2% in April in US dollar terms as bond markets remained cautious following the previous month's banking sector-induced volatility. The 10-year US Treasury yield was stable as were emerging market credit spreads, which continue to trade in line with the last 20-year average.

There was some positive underlying corporate news across the portfolio. Total Play (Mexico; communications) addressed some near-term refinancing risks by accessing local capital markets. This alleviated pressure on the company's liquidity at a time when broader credit markets have tightened and helped bond prices recover.

MHP (Ukraine; agro-industrial) results highlighted a high degree of resilience with poultry production volumes and most exports continuing despite war-related logistical challenges. Credit rating agencies upgraded the company following the extension of bank loan maturities and management's commitment to fully service current and deferred Eurobond coupons.

Finally, our oil and gas companies in Ghana benefited from a combination of factors. OPEC surprised the market with an announcement of oil production cuts that supported oil prices. Separately, progress on an IMF loan to the government added broad support to Ghanaian corporate asset prices.

Macro conditions will continue to have a significant impact, with the market focus shifting from inflation to economic growth. We believe that we are likely to see a widening differential between emerging market and developed market as well as a benign dollar, which is supportive of emerging markets. On a company level, corporate credit fundamentals continue to be strong although peak credit quality is likely behind us. Valuations continue to look attractive with spreads and yields providing protection again recession risk. The level of new issuance is running below trend which provides a supportive technical backdrop. It is an opportunity for investors to lock in attractive income and total yields by selectively buying and holding bonds to maturity.

Our Emerging Market Bond strategy offers a 12.6% per annum yield to maturity (in US dollar terms) with a relatively short duration of 3.8 years. This comprises a 7.9% per annum income yield which provides a degree of visibility on future returns as well as capital appreciation potential given the average bond price is 88 cents on the dollar.

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