Investment Commentary

The Golden Path

September is an important month as investors look to expectations for the end of this year and the prospects for the year to come. At the beginning of the year we said that we thought that we had taken the blows on inflation, interest rates and valuations, and that this would be the year in which we would see normalised interest rates for the first time since the global financial crisis. With US 10 year rates now at 4.3% we have reached that important milestone.

Austin Goolsby, the economist and president of the Chicago Federal Reserve Bank, has managed to coin a new term to describe what we think: Goldilocks is the typical expression for an economy in which growth and inflation are neither too hot nor too cold but just right. The golden ratio has been a measure of harmony since antiquity.

In an interview last week, Goolsby spoke about his view that the economy was on a golden path in which inflation would fall but recession would be avoided. He said that monetary policy was working and that the Fed was "nearing a point when it is not a matter of raising rates but how long to keep them high." Goolsby referred to a study by economists at the Chicago Fed stating that "the policy tightening that the Fed has already done is sufficient to bring inflation back near the Fed's target by middle of 2024 while avoiding a recession." You can read the study on the Chicago Fed's website here.

https://www.chicagofed.org/publications/chicago-fed-letter/2023/483

Whether it is Goldilocks or the golden path, we think that the underlying economy and in particular the quality companies we invest in are well positioned and will weather the challenges from higher interest rates. Resilience is an important attribute of quality and it is what we are expecting from our companies. They benefit from many important drivers of economic growth and investment, including the need to renew the public and private infrastructure in the United States, Europe and elsewhere; the need to invest in energy transition, water management and other improve public utilities; and the need to increase computing capacity for accelerated computing as artificial intelligence, the metaverse and the internet of things change the course of the digital economy.

Nvidia has been in the World Stars portfolio for over 18 months and it has now become our largest position following its 215% rise year-to-date. The strength in the share price has been driven by rapidly growing demand for Nvidia's high performance GPUs as data centres are changing to an accelerated compute infrastructure. In recent months we have been asked whether Nvidia's valuation is too high or market expectations are unrealistic and have gotten ahead of themselves. Our investment case on Nvidia focuses on its competitive position, its addressable market and its valuation. As Giles Tulloch outlines in our investment insight this month, Nvidia continues to be exceedingly well positioned across all three. We believe that the company has the potential for significant upside in the coming years and have decided to keep it as a core position in our portfolio.

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World Stars Global Equities

Our World Stars Global Equity strategy closed August down -1.7% and is now up 24.8% year-to-date, both in US dollar terms. The strategy has outperformed global indices strongly this year and performed resiliently last month, declining slightly less than indices despite its strong performance this year. You can find our latest factsheet here.

More than half of our holdings saw increased earnings estimates for the financial year as the second quarter's earnings season came to a close in August. Strong earnings were most notable in companies involved in digital transformation where AI-related opportunities are fuelling revenues and deepening competitive moats. At the same time, industrial companies benefit from a large number of drivers including decarbonisation, reshoring, automation, defence and infrastructure that provide structural tailwinds to our holdings, many of which saw record levels of orders. Finally, consumers in the US, Europe and China continued to spend in key categories, whether luxury goods, personal care products or special experiences, including travel.

Performance in August was led by *Eaton*, the global power management solutions provider, which was up 13% (up 49% year-to-date), on the back of yet another solid earnings release. Revenues grew by 13% in the second quarter of 2023 while its backlog of orders reached record levels at USD 12.1 billion, almost three times 2019 levels. The company is emerging as a major beneficiary of key structural trends within the industrial sector, including the transition to net zero, the reshoring of critical industries, investments in refurbishing ageing infrastructure and growth in data centre capacity.

Advanced semiconductor leader, *Nvidia*, continued to benefit from the unfolding inflection in AI investments. It posted USD 13.5 billion in quarterly revenues, double last year and 20% ahead of market expectations. The stock is already up 238% year to date and the company has guided for revenues of USD 16 billion for the upcoming quarter, pointing to the breadth of demand across applications.

Our payment provider holdings continued to point towards resilient consumer spending despite recent inflationary pressures, with cross-border travel activity remaining particularly robust.

On the weaker side, several of our holdings gave back some of the prior month's performance on broad-based market profit-taking. Destocking by distributors within some markets affected our spirits companies after the last years of exceptional growth. However, destocking is part of the normalisation process we have been witnessing and, which is reaching a close. Importantly, consumer demand for premium spirits, the key structural driver for the sector, remains intact.

Meanwhile, broader concerns around the health of China's economy weighed on some of our holdings within both the consumer and industrial sectors. However, we believe the market is underestimating the breadth of levers at the government's disposal to support the economy through stimulus programmes. The Chinese economy is also still in the early throes of re-opening after years of COVID restrictions, a process that took the US and European economies a long period to fully achieve.

Multi-Asset Income

Our multi-asset income strategy was down by 0.8% in August and is up 10% year-to-date, both in US dollar terms. You can find our latest factsheet here.

August was a month of two halves as market participants digested the lingering post-pandemic normalisation. The US economic soft landing seems to be the consensus and as markets adjusted their expectations for lower interest rates, risk assets corrected to the downside. Subsequently, equities reversed some of their previous months' performance, down 1.6% in August (up 24.5% year-to-date). Our fixed income portfolio proved to be slightly more resilient falling just 0.6% (up 5.6% year-to-date). Our non-correlated funds were flat last month (down 2.6% year-to-date).

Despite a very constructive corporate earnings season, equities suffered mostly from profit-taking following some strong performances since the start of the year. *Estee Lauder's* shares (-10%) suffered further as a result of negative revisions in earnings and a lack of visibility on the outlook for 2024. *Siemens Healthineers* (-13.8%) was impacted by a slight miss in operating profit, which led to downgrades to the full year's margin.

Our funds saw the positive performance of recovering HICL (+2.1%) and Sequoia (+1.2%) offset by further concerns for UK interest rates in the face of sticky inflation data.

The performance of our bond portfolio was fairly balanced although spreads widened slightly. A few idiosyncratic stories detracted from the generally positive performance (see our Emerging Market Bonds commentary).

Our overall fixed income exposure (including US Treasuries) is now close to 56%, reflecting where we see the relative opportunity going forward. With the global economy losing pace driven by a deteriorating growth outlook in Europe and a patchy economic recovery for China, we expect volatility to rise before the end of the year despite a very resilient US economy.

Year-to-date, our strategy has generated a 3% cash income yield and is on course to achieve close to 4% for the whole year. The current positioning should provide a reasonable volatility buffer as well as the opportunity for further gains from bond prices.

Emerging Market Bonds

Our Emerging Market Bond strategy was down 0.8% in US dollar terms for the month but is still up 3.5% year-to-date. You can find our latest factsheet here.

Performance was driven by a steepening US Treasury curve as the recent strength of US economic data drove the yield on the 10-year note to the highest levels since before the 2008 financial crisis. Emerging market credit spreads widened marginally and now trade just inside the last 20-year average.

Second-quarter earnings for companies were mainly robust with leverage still below pre-pandemic levels. Highlights include *Cemex* (Mexico, industrials), which reported record quarterly EBITDA with significant margin recovery. Operating performance helped net leverage decline to its lowest level as management targeted an investment-grade credit rating.

Our Turkish corporates also benefited indirectly from the decision of the central bank to raise interest rates. It marks the third consecutive hike since President Erdogan's re-election and is in line with a shift to more orthodox economic policies to tackle inflation.

Aside from the duration effect, the main detractors from performance were *Total Play* (Mexico, communications) and *Wom* (Chile, communications) given the focus on refinancing risks. Their latest results highlighted continued revenue and EBITDA growth driven by increased demand for their services. Despite healthy operating metrics, both companies high-growth capital expenditure means they are cash flow negative. This put pressure on liquidity at a time when broader credit availability is low.

The market is focused on the resilience of economic growth with probabilities skewed towards a soft landing. Corporate credit fundamentals are resilient although we think that peak credit quality is behind us. Interest rates are stabilising with the first cuts priced in towards the middle of 2024. This should be supportive of the asset class.

Today, our Emerging Market Bond fund offers a 12.9% p.a. yield to maturity (in US dollar terms) with a relatively short duration of 3.5 years. This comprises a 7.6% p.a. income yield which provides a degree of visibility on future returns as well as capital appreciation potential given that the average bond price is 83 cents on the dollar.

September 2023

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