J. STERN & CO.

Investing in Quality for the Long-Term

Investment Commentaries

Micro is What We Do, Macro is What We Put Up With

One of our favourite quotes by Charlie Munger is "Micro is what we do, macro is what we put up with". It has never felt more relevant than in 2024, a year of elections. Like in investing, in politics fundamentals matter. James Carville, Bill Clinton's campaign manager famously said in 1992, "It's the economy, stupid," but this year, it's more accurate to say, "It's the inflation, stupid." Real and perceived concerns about the economy, and the reality of the high inflation and lagging incomes over the past two year, are among the key reasons for the election outcomes in the UK, France, Germany and most important of all, the US.

Fundamentals drive both financial markets and politics. They also impose necessary constraints on both foreign and domestic policy, including trade and regulatory frameworks. That is why they are also our greatest source of confidence as we look ahead. Donald Trump and his incoming administration will have opportunities to implement the pro-growth initiatives advocated during the campaign. These measures will require a functioning economy, free trade, a stable legal and regulatory framework, and above all, healthy financial markets to create a more prosperous nation.

One of our own convictions is that 'everything may be OK'. The US economy remains resilient. Employment is strong, inflation is easing and interest rates are beginning to decline. We believe we are at the peak of the consumer squeeze, with recovery on the horizon. Just as the pandemic's disruptions and the sudden normalization of interest rates had a lagged negative impact on inflation, the current recovery will bring a lagged positive effect.

At the core of our strategy is a focus on quality - quality companies with strong fundamentals and attractive valuations. That's why we have used recent opportunities to reduce positions in some technology and industrial companies, which have performed exceptionally well, for risk management and valuation reasons. We have reallocated capital to consumer stocks that have sold off, increasing our stakes in outstanding global companies now trading at discounted prices. In 2022 markets believed that digital advertising was over and in 2024 it's that people will no longer buy branded food, coffee or cosmetics, feed their pets, buy handbags or have a glass of whiskey. Whether it's stocks or socks, as Charlie's business partner Warren Buffett likes to say, we love buying quality when it's on sale.

Quality will matter even more in the period ahead. With resilient growth accompanied by sustained inflation, we believe quality companies will have the edge. They benefit from innovation, pricing power, scale, strong cash flow, and balance sheets that enable reinvestment and strategic acquisitions. These attributes have underpinned our portfolio's strong returns over the last decade, despite significant challenges, and they will continue to drive resilience and value creation in the long term.

Engagement is another cornerstone of our philosophy. We see sharing insights and contributing to public discourse as a key part of our commitment to our clients and broader stakeholders. Instead of an investment insight this month, we are sharing a recent interview with our CIO, Christopher Rossbach, in City AM, a UK publication. In the interview, Christopher discusses our World Stars Global Equity strategy, its differentiation, and the sources of its strong performance. You can watch it by clicking on the link here or in the attachment.

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World Stars Global Equity

Our World Stars Global Equity strategy consolidated its performance in October, down -4.2% in line with weak global markets but remains up solidly for the year at 15.6%, both in US dollar terms. You can find our latest factsheet here.

The month saw ongoing strength among our digital transformation and industrial holdings.

Nvidia (+9%) benefited from commentary around the sustainability of levels of AI spending by some of its major customers, who can already evidence cash returns on their investment. A good example of this is *Alphabet (+3%),* the owner of Google, on the back of 16% growth in Q3 revenues on constant currency, with the company noting that over one billion users within its search business receive AI Overviews, a feature that is being rolled out in over 100 countries currently. Alphabet's cloud business grew an impressive 35%, with the company noting that its own customers are seeing proof points on AI.

Connector and sensor manufacturer *Amphenol (+3%)* reported strong Q3 earnings across its communications end markets led by its IT & Datacom business, with revenues up 59% amidst the strength of data centre investments. With interconnect systems playing a crucial role in the ultimate performance and economics of AI projects, Amphenol is well placed to benefit from the current boom in spending.

Overall, however, it was a month of broad-based consolidation across markets after the strong run in prior months.

Amongst our other stocks, semiconductor equipment producer, *ASML* (-16%), came under pressure after reporting disappointing new orders. We believe that this constitutes a pause in orders reflecting new fab construction delays and idiosyncratic issues with its larger customers rather than outright cancellations. ASML commands an effective monopoly in next-generation lithography equipment and the structural drivers of the thesis, the proliferation of semiconductors across applications, the reshoring of critical industries and the drive for advanced semiconductors fuelled by AI all remain intact.

There was also weakness in some of our consumer holdings, with spirits producer *Pernod-Ricard* and cosmetics leader *L'Oréal* both down 15% as consumer spending remained muted. Although this part of our strategy has detracted from its performance in recent months we believe that the issues are fully discounted in the stocks' valuations, in many cases trading at 15-20% discounts to their historical levels. With the labour market remaining tight in key markets and declining interest rates we expect that consumer spending will recover in the categories in which our companies participate. Importantly too, recent headwinds in the spirits category, most notably the normalization of inventory levels across the value chain post Covid-19 are now behind us, making these holdings coiled for performance as we move into 2025.

Multi-Asset Income

October saw volatility rising from the previous month and risk assets came under pressure despite a 50bps cut in US rates in mid-September and an indication from the Federal Reserve of a further cut before the end of 2024. As a result, our Multi-Asset Income strategy pulled back by approximately 1.0% (still up 14.1% for the year) in US Dollar terms. Equities and funds contributed negatively (respectively -1% and -0.25%) whilst our fixed income portfolio contributed a positive 0.5% with the difference coming from exchange rate on cash holdings.

Ahead of the earnings release season markets started to focus on the possible outcome of the US election and US treasuries corrected accordingly in expectation of possible higher inflation. With the lack of news and in low volumes *Siemens Healthineers* (-6.5%) and *Eli Lilly* (-6.9%) came under pressure. Estee Lauder's (-22.2%) management surprised the market by withdrawing the 2025 guidance blaming the worse than expected retail travel activity in Asia.

The fixed income portfolio was particularly impressive in light of the correction in US Treasuries, with most bonds performing positively but with some idiosyncratic credit stories working particularly well (See Emerging Market Debt below).

Our funds had a difficult month and suffered some profit taking ahead and after the announcement of the UK budget despite the lack of direct impact from the new fiscal policies. However, rising yields as a result of the expected increased issuance of government debt put pressure on investment trust valuations.

The recent macro news flow confirmed that the US economy is in rude health, certainly relative to other parts of the world, although inflation is somewhat stickier than the US Federal Reserve would wish. Markets have been watching the metrics on the US labour market which is expected to slow down but not decline significantly. Therefore, investors' expectations for relatively aggressive interest rate cuts this year and next could be overoptimistic.

We still believe that, although the US elections are now behind us, volatility could remain elevated. In the multi-asset strategy, we have gradually reduced exposure to equities during the second half in accordance with our investment approach and reinvested the proceeds into our emerging market corporate bonds which provide a good degree of visibility on future returns and cash flows. Therefore, we feel that the strategy is well positioned for the end of the year.

Emerging Market Debt

Our Emerging Market Debt strategy was up 0.3% for the month and 10.6% year-to-date, both in US dollar terms. Performance was resilient in a month where broader risk assets were volatile. This was due to uncertainty ahead of the US presidential election and mixed economic data. The combination led to US Treasury yields widening significantly. This move was only partly absorbed by emerging market credit spreads. You can find our latest factsheet here.

The strategy's strong absolute and relative performance was supported by its high income yield, short duration and positive idiosyncratic credit stories. There were highlights from different countries and sectors as earnings season began. *Trans-Oil* (Moldova; agri-commodity) saw a strong rebound in crop yields and better demand across regions. The company proactively managed its debt maturity profile which included a tender offer to buy back its 2026 US Dollar bond at par.

Liquid Technologies (South Africa; communication) reported improving results driven by increased demand for its infrastructure solutions. They also finalised an equity raise with the

US International Development Finance Corp as a cornerstone investor. This highlighted the sector's importance and structural tailwinds on the continent.

Total Play (Mexico; communication) continued to monetise its network via higher subscriber penetration rates. Capital intensity also decreased which translated into better free cash flow and liquidity. The company demonstrated its continued access to local capital markets to address near-term debt liabilities.

Finally, *Kernel* (Ukraine; agri-commodity) repaid in full and on time its 2024 US Dollar bond. This underscored the company's commitment to bondholders and led to a rally in their longer dated bonds. They also raised a new US$150m pre-export facility from a syndicate of European banks to funds working capital needs.

The market's focus is now on the US president-elect and the impact that an expansionary fiscal policy will have on the economy. The pace of Fed interest rate cuts will be data dependent and is likely to provide bouts of volatility. Importantly, underlying credit fundamentals remain robust and default rates are in check. Investor positioning is light which is also a supportive technical.

Today, our Emerging Market Bond strategy offers a 9.3% per annum yield to maturity (in US dollar terms) with a relatively short duration of 2.5 years. This comprises a 7.4% per annum income yield which provides a degree of visibility on future returns as well as capital appreciation potential given that the average bond price is 96 cents on the dollar.

As always, we look forward to your questions and comments.

Best regards,

Chris

November 2024