Honey, Patience and Profits

Investing is a lot like Winnie the Pooh's pursuit of honey: slow, steady, and guided by a simple but unshakeable focus on the prize. In today's fast-moving world, it is easy to be swayed by the lure of quick gains or to be scared of volatility, but long-term investors know that lasting success comes from identifying quality businesses and holding onto them with patience. Much like Pooh's endless search for the perfect honey pot, a wise investor seeks out companies that are fundamentally sound, even if it takes time for the market to recognize their true worth. In investing, as in life, the sweetest rewards come to those who are willing to wait.

August has been volatile, and clearly September is turning out to be volatile as well. There is a lot going on in the global economy and in politics. We are clearly at a key turning point, with the Fed decision on rates expected imminently and formally ending the interest rate cycle which started with the recovery from the pandemic in 2022. The fact that markets are volatile in the run up, and that people are looking to position themselves short-term, is something that is to be expected. It has obviously affected investors and markets in August and will do so going forward as well.

Winnie the Pooh has said that "Doing nothing often leads to the very best of something." Our approach has been to stick to our convictions and to base our decisions on the long-term fundamental analysis of the quality and prospects of the companies we invest in. Of course it is not about doing nothing, ever. Pooh likes honey at least as much as we like quality companies. It is about two key things: having the wisdom and patience to know when we should act and when we should not; and putting ourselves in a position where we can act out of a position of strength and do not have to react at a time of adversity. We have been able to make the most of the mis-pricings we have seen over the past several years to buy great companies at great prices and to build a resilient and diversified portfolio of globally leading quality companies that has performed strongly through this period of volatility.

Earlier this year reduced the exposure to a number of positions that had performed strongly, because of portfolio, risk management and valuation considerations, and allocated the capital to new and existing positions that we thought offered great prospects. By doing so we did not have to do anything to react to the short-term volatility and have been able to focus our resources on reinforcing our conviction in the companies we hold and working on others that we think are fully priced but may become opportunities in the future as so many of our companies have.

The volatility has largely been due to concerns around macroeconomics and in particular, indicators of a US slowdown, issues that we think are expected. As we have said, the thing about Goldilocks in markets, as opposed to the fairytale, is that it's never just right, it is always too hot or too cold. That is exactly what we are seeing, and it has been one of the main things that has been a driver for the performance of the overall markets and to some extent also of our portfolio up 18.1% year-to-date in USD at the end of August, with the positive performance we summarize below.

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

45 Rockefeller Plaza, 21ST
Floor, 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

One of the most important things for us is the diversity of the companies we hold. We hold companies in digital transformation, healthcare, consumer and industrials, and it has been an important source of the strong performance this year but is also one of our key differentiators.

We continue to be positive about the outlook for our companies. If anything, the differential has increased in terms of the higher growth and the valuation discounts that our stocks are trading at.

There has been a broadening in markets already that we have participated in, and we believe that it will be a source of strength going forward. Some of the lagging stocks this year that we have been buying have now started to perform. They are fundamentally cheap and in some cases their shares have not done very well, so we believe they are poised to perform if their businesses perform as we expect.

We believe that this is the case for high growth stocks, including some of the ones we own, but it is also and especially the case for some of the stocks in consumer products that have performed poorly this year. Even on price/earnings ratios, the simplest metric, stocks like Nestle, Diageo or Pernod Ricard are trading at multiples that are 20-25% below their usual ranges. These low multiple stocks are pricing in outcomes that we are not expecting.

Taking into account the opportunities for the companies we own, but also the overall macroeconomic and geopolitical environment, we believe we are well positioned for what we think is a central case outcome of a slowing US economy, moderate but sustained inflation and lower rates. There is clearly going to be volatility, including of course from the US elections. The outcome cannot be predicted at this point and will certainly have an impact on geopolitics and on markets. Even if, in many ways, the two presidential candidates are likely to have positions that are in continuity with what overall US policies have been, there are going to be areas of difference and it is something that we will have to keep taking into account going forward.

Like this time last year, we believe that the kinds of reversals we have seen last month are opportunities to buy the quality stocks that we like at lower prices.

Across the portfolio we expect that the growth that the companies will deliver means that the weighted average valuation of the portfolio is extremely reasonable, and points to this moment as a significant opportunity for equity investors that is presented to us as a result of the macroeconomic and geopolitical concerns that we are facing.

Our long-term approach and our active portfolio management have served us well at this turning point and we have every confidence that it will do so going forward.

Our Investment Insight this month is on Emerging Market debt as a resilient and diversifying asset class. Please click on the link here or on the attachment.

World Stars Global Equity

Our World Stars Global Equity strategy performed resiliently in a volatile month. It closed August up 2.2%, broadly in line with global indices, and is up strongly year-to-date at 18.1%, both in US dollar terms. You can find our latest factsheet here.

Performance was led by *Meta*, owner of Facebook and Instagram. Its shares were up 10%, as the company's quarterly results highlighted ongoing momentum in digital advertising with revenue growing 22% and more active users joining its community platform. Meta continues to broaden its competitive moat versus peers, with its recent investments in AI reaping results in terms of user engagement and conversion. The company continues to see transformational potential in AI, guiding towards annual investments of US$37-41bn in capex, as it seeks to overcome compute capacity constraints and suggesting that the cost to train the next version of its Large Language AI Model (Llama) will be almost 10x that of the current generation.

This message, echoed by other participants in the industry, underscores the ongoing demand for *Nvidia's* advanced semiconductors. Nvidia closed the month up 2%, reporting record revenues of US$30bn, and guiding towards US$32.5bn for the upcoming quarter. Though expectations for the company were high and some profit-taking was inevitable, demand remained strong. Customers such as Meta are seeing real returns on their AI investments and the client base continues to broaden, with sovereigns including those in India, Japan, and Saudi Arabia investing in their national infrastructure. At the same time, its upcoming next-generation Blackwell chip will deliver significant performance improvements fuelling the next demand wave.

One of the most encouraging elements of the month's performance was the diversification of its sources. This is a pattern we have seen consistently over the past few months and it reflects the active management of exposure to our holdings and the positioning of the strategy across sectors.

Within the healthcare industry, medical devices manufacturer, *Abbott Laboratories*, was up 7%. The stock bounced on the back of strong earnings results released a month earlier and on the announcement of a lucrative partnership with Medtronic in the fast-growing insulin pump market. Within the industrials sector, aerospace system manufacturer *RTX* was up 6% on ongoing momentum in both its commercial aerospace and defence businesses and as the market gains increasing confidence that the company is on track to deliver on its GTF accelerate maintenance programme, on time and on budget. Within the consumer staples area, we have seen tentative signs that the inventory normalisation cycle is reaching its natural conclusion, which positions holdings such as *Pernod Ricard* and *Diageo* towards the path to recovery in the months ahead.

On the negative side during the month, we saw some profit taking in our digital transformation holdings after months of exceptional performance. *Amazon*, for example, was down 5%, as strong results in its cloud computing business, AWS, were overshadowed by weaker numbers in its e-commerce business as consumers became more selective in purchasing big ticket items and downtrading in some categories. However, with the labour market remaining strong and with the Federal Reserve poised to cut rates imminently, we believe consumer sentiment and the willingness to spend will inevitably pick up again.

Multi-Asset Income

In a rising volatility environment, our Multi-Asset Income Strategy delivered strong positive performance of 1.7% for the month and is now up 13.7% for the year, with relatively low volatility and both in USD terms. All asset classes contributed positively, led by equities, which were up 2.9% in August (up 21.1% year-to-date) with continued strength from our fixed income portfolio up 1.3% (up 10.5% year-to-date) and a recovery in our funds' portfolio up 1.1% (up 10.9% year-to-date).

Last month saw some large moves in share prices mostly driven by earnings releases. A good example was *Eli Lilly* (+20%), which reassured the market of the future potential for growth going forward. Sales were up 36% and earnings per share grew 86%, 50% above expectations. Management also again raised guidance for the year. On a less positive note, *Estee Lauder* (-7%) was affected by lower guidance for 2025, the announcement of the CEO's departure and continuous weak news flow out of China.

Our fixed income portfolio benefited from lower Treasury yields as a result of softer US economic news and some flight to safe havens, as well as some idiosyncratic contributors (see Emerging Market Debt commentary).

Our funds saw mixed contributions but *Biopharma Credit* (+2%) remained a strong component without specific news flow.

The Federal Reserve's focus on supporting the US labour market from inflation and clear signs that it will cut interest rates from this month have fuelled speculation that they could be greater than expected. Such cuts can only be justified by some substantial deterioration in economic activity and especially job creation (or lack of). This is unlikely considering how the US economy has performed so far this year, although some slowdown is expected. Subsequently, as the earnings release season for equities recedes, markets are mostly going to be driven by economic data which could lead to increased volatility. This could be further exacerbated by uncertainty around the forthcoming US elections.

We have reduced risk across our portfolio by lowering the exposure to equities and as well shortening the duration of our fixed-income portfolio. We believe that we are well positioned to manage the end of this year with a strong focus on income generation.

Emerging Market Debt

Our Emerging Market Debt strategy was up 1.4% for the month and up 8.8% year-to-date, both in US dollar terms. It was a volatile start to the month for global risk assets triggered by a combination of macro factors. US Treasury yields tightened sharply. Risk sentiment improved later in the month and asset prices recovered on signs the economy remains resilient. Emerging market credit spreads ended the month at similar levels to July. You can find our latest factsheet here.

There was positive underlying corporate news. *Liquid Telecom* (South Africa; Communication) announced its planned US$225m equity raise is expected to be completed by the end of the year. The US International Development Finance Corporation, an agency of the US federal government, will be a cornerstone investor, highlighting the importance of the sector on the continent. This fresh investment will support ongoing debt refinancing efforts and existing lenders have provided additional covenant headroom.

IHS Towers (Nigeria, Industrial) renewed and extended its tower contract with its largest customer MTN, providing better revenue visibility for the next decade. Management also talked of asset sales of up to US$1bn over the next year, which could be used for debt repayment.

More broadly, the 2Q24 earnings season illustrated stable fundamental trends across most sectors. Highlights included *Rumo* (Brazil; Industrial) which reported EBITDA year-on-year growth of 48%. This was driven by a double-digit increase in tariffs reflecting the favourable competitive environment for rail logistics in the country.

During the month, we reduced the duration of the overall strategy. We also took profit in a Ukrainian company and switched from the unsecured to secured part of the capital structure in an Argentine company.

The extent of the economic slowdown and Fed policy are firmly in focus, with its chair, Jerome Powell, signalling interest rate cuts are imminent. This is likely to provide further bouts of volatility. However, underlying credit fundamentals remain robust and technicals are supportive.

Today, our Emerging Market Bond strategy offers a 10% per annum yield to maturity (in US dollar terms) with a relatively short duration of 2.7 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 the average bond price is 96 cents on the dollar.

We hope you are well and look forward to your questions and comments as always.

September 2024