

J. STERN & CO.

Investing in Quality for the Long-Term

Opportunity knocks beyond the magnificent seven

The ‘great rotation’ in stock markets since the US Fed started raising rates at the end of 2021 has favoured many great technology companies. However, the rotation has left behind many other companies that have high quality and offer great upside as well.

We have invested in several great technology companies, including *Amazon* and *Alphabet* since the inception of our World Stars Global Equities in 2012, and more recently *Nvidia* and *ASML* in 2022 and 2023 respectively. They have helped our World Stars Global Equities to perform strongly and we are pleased to be ranked in the first decile of performance in the latest IA Global index to 31 March 2024, over 1, 3, 5 and 10 years (although past performance is of course not a reliable indicator of future results).

Equities are the only large and liquid asset class that offers investors the ability to generate real returns in an environment of solid economic growth and sustained inflation. It is perfectly normal for higher growth companies to perform better at first and we still see great value in the technology stocks we hold.

We have always been selective, applying our quality criteria and looking for companies with strong growth opportunities, sustainable competitive positions, a high proportion of recurring revenues, experienced management teams and high levels of cash generation. Subsequently, we have positions in consumer, healthcare and industrial companies trading at valuations that are at multi-year lows, in absolute terms and relative both to the market and to their own long-term trading ranges.

Our approach has always been to invest in a broad set of companies that fulfil our quality criteria and can compound over long periods. Since 2012, technology companies *Amazon* and *Adobe* have been the two top performers but the next two are industrial company *Eaton* and healthcare company *Thermo Fisher*.

That is why we have expected stock markets to broaden from their narrow focus on the Magnificent Seven (*Alphabet*, *Amazon*, *Apple*, *Meta*, *Microsoft*, *Nvidia* and *Tesla*), some of which we think are less magnificent than others. The first quarter of this year has seen this broadening accelerate as investors have become more selective and the reality of company fundamentals has prevailed over sentiment and hype.

The demand for increasing capacity, artificial intelligence and other applications will be important drivers of growth and productivity for the global economy and our companies. So will increased healthcare spending and support of an ageing population; the renewal of the public and private asset base in the US, Europe, China, Japan, and just about everywhere else; and the need to address challenges like global warming, energy transition, carbon reduction and water supplies.

Our companies are leaders in these markets and for them, these great challenges are great opportunities for growth and value creation. Here are four examples of stocks we hold in our World Stars Global Equity Fund outside the technology sector.

Eaton (Industrials)



Eaton, the global leader in power management solutions, is a great example and a stock we have owned since 2024. It was up 56% in 2023 and is 33% ahead year to date in 2024. The

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company finished FY23 with 12% organic revenue growth, fuelled by its Electrical Americas and Global divisions. Perhaps the best indicator of the opportunity ahead is the level of projects in the US of over US\$1 billion in value announced since January 2021. At the end of FY23, these mega projects stood at US\$933 billion, having grown from the US\$600 billion level at the beginning of 2022. Activity levels are running at three times the historical rate, reflecting heightened activity across a wide range of markets, including semiconductors, batteries, electric vehicles and renewable power generation.

Eaton is in the early innings of a multi-year runway of investments in its key markets; 80% of these announced projects have yet to start and when they do, lead time to orders is around two to three years. At the same time, AI is fuelling investments in the industrial sector, a connection that is often overlooked. Eaton's data centre vertical is seeing a significant acceleration in demand, with power management requirements being 3x higher for data centres that serve AI-related applications than traditional ones. Against this background, it is of little surprise that its backlog stands at a record level of US\$12.8 billion, three times the US\$4.2 billion at the end of 2019, setting the stage for another record year in 2024.

Thermo Fisher (Healthcare)



Thermo Fisher is the world's leading life sciences player with a 15% share in its addressable market. The life sciences industry benefits from strong structural growth trends, including demand for biologics, robust pharma pipelines and a growing focus on precision medicine. Thermo has been a consolidator in a still fragmented industry, with an exceptional track record in integrating acquired assets. It has a strong innovative track record within its core businesses, supported by the highest R&D budget in the industry at US\$1.5bn, underpinning its pricing power and gross margin structure.

It offers the broadest portfolio in the industry, with products and services across the value chain. The strength of the operating model became clear during the Covid-19 pandemic with the company participating in over 250 projects related to research and vaccine development as well as offering a wide range of testing solutions. In so doing it generated over US\$23bn in revenues in the period 2020-23, reinvesting the proceeds in R&D, organic capacity expansion and numerous acquisitions. This included the US\$17bn purchase of clinical research provider PPD, further entrenching its leadership position within the sector and expanding its addressable market.

LVMH (Consumer goods)



LVMH has long been a major holding in our flagship World Stars Global Equity Fund. We believe the luxury sector has hit the bottom and is poised for a recovery pending a better macroeconomic outlook. We see a year of two halves in 2024.

The normalisation of the sector growth will continue into the early part of the year. As inflation subsides and interest rates begin to stabilise and even come down, consumer sentiment should improve. This combined with greater numbers of international tourists from China in the second half of the year and cheap valuations, should see improved performance as market sentiment turns.

The long-term investment case on the luxury sector remains unchanged. Growth in the sector continues to be powered by structural demand; pinned on the aspiration of consumers to

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own luxury brands, by the rise of the middle class in emerging markets, and by strong brand equity and pricing power.

The re-opening of China will be a catalyst for the sector. Chinese consumers have been the engine of growth pre-pandemic, accounting for almost a third of all luxury demand. The recovery of Chinese consumer spending is still at an early stage, but we see an acceleration of the growth in the sector led by Chinese consumers in the coming year despite the likely normalisation of demand from US and European consumers. They say a rising tide lifts all boats. When the race for luxury gets going LVMH will have the wind in its sails.

Walt Disney (Media)



We believe that the market continues to undervalue the strength of Walt Disney's businesses, its operational turnaround and its restructuring potential. We have seen a resurgence in attendance post-pandemic at its Disneyland and Walt Disney World theme parks as well as other parks, cruises and other holiday destinations.

The company's theme parks business, which attracts higher purchasing power consumers, continues to report robust growth as it laps the Anniversary celebrations. It has announced plans for significant expansion of the parks and cruises business over the next decade.

It also has a road map to double-digit operating margins in its streaming business and the potential to dispose of non-core assets. First, in the media division, the company owns a deep library of iconic content and franchises and we believe that it can make the transition to a very profitable streaming platform at scale. Pixar, Marvel, and Star Wars are taxes on parents. You have no choice but to buy them. Additionally, a renewed focus on the creative Studio output can improve box office returns.

The overall TV industry is transitioning away from the cable bundle and whilst Disney will lose revenues from this, it can gain much more from its streaming platform. It also owns ESPN, which is the leading sports network and live sports continues to have strong advertising demand. Disney can monetise this further, possibly as a standalone flagship app incorporating adjacent content enhancing the user experience such as fantasy sports and statistics.

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