J. STERN & CO.

Investing in Quality for the Long-Term

Investment Commentary

At a time of great political and economic uncertainty and conflict, our responsibility as investors and as fiduciaries of the capital we manage is to focus on the fundamentals of the companies we invest in and on their long-term prospects for growth and value creation.

We do not seek to time markets, but to choose quality companies that will deliver significant returns over time, through economic and investment cycles, and periods of uncertainty and adversity. This philosophy has delivered in previous periods of volatility and we remain confident that it will continue to do so going forward. It also lends itself to low turnover and long holding periods.

We believe that interest rates have finally normalised for the first time since the financial crisis and we are very close to peak rates in the US and Europe. We do not believe that US interest rates have to rise much from here if at all but we also do not believe they need to fall.

This normalisation of interest rates is a positive and we very much believe that 'the new normal' which people have been so worried about, will be more like the good old days. We are in a Goldilocks environment. Of course we wish the global economy were like the fairy tale where the little bear's porridge is just right. The reality is that economic data will never be just right, it will always be too hot or too cold. What matters is the outcome: a world in which nominal interest rates are between 4-6%, where inflation is sustained at 2-4% and therefore real interest rates are between zero and 2% is a world to look forward to – not to be afraid of.

Our rigorous approach to investing in companies that have quality and can compound over the long term leads us to invest in the world's largest and best companies, many of which are also disruptors. These companies have enduring and sustainable competitive advantages in attractive long-term growth industries, notably information technology but also consumer products and services, healthcare and life sciences, and industrials and infrastructure. They have above-average pricing power through branding, ownership of intellectual capital or similar and low exposure to the main areas of current inflationary pressure in their cost base.

We are only at the beginning of the digital transformation of the global economy and there is much more to come. Computing capacity will increase exponentially and offer many opportunities for companies providing products and services to businesses and consumers. Companies like Alphabet and Amazon have been holdings for the past ten years. Last year we bought Nvidia and this year we bought ASML. These companies will be will be long-term beneficiaries from digital transformation, we expect them to continue to represent a large part of our portfolio.

Our investment insight this month analyzes one of the great issues we face: the global water crisis and the challenges and opportunities it offers. Here too, as investors we believe we have an important responsibility to understand the systemic risks, to engage with companies on how to address them, and to take advantage of opportunities to invest in companies that provide solutions. You can read our investment insight by following the link here or by clicking on the attachment.

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World Stars Global Equities

Our World Stars Global Equity strategy closed the month down - 1.6% and is now up 13.5% year-to-date, both in US dollar terms. It performed resiliently in weaker markets and continued to outperform global indices.

The portfolio performance this month was impacted by market rotation as stronger than expected economic data led investors to position themselves for higher interest rates and by ongoing profit-taking in companies that had exhibited strong outperformance in the first six months of the year. This included several of our companies in digital transformation, industrials and luxury goods.

The underlying earnings posted during the third quarter results period remained robust. Digital advertising companies benefited from their AI offerings and the ongoing willingness of advertisers to allocate more dollars to digital given the medium's better ROI profile.

Equally, our holdings within the industrials sector reported strong trends, with reshoring, the transition to net zero, and infrastructure stimuli programmes underpinning demand and backlogs that are at historical highs. Within the consumer goods sector, consumers in China continue to fuel demand for luxury products, offsetting pockets of weakness in the US and Europe where higher cost of living pressures have tempered spending.

RTX, the leading aerospace systems and engines supplier, recovered 13% as the company reassured the market that historic manufacturing issues affecting its GTF (geared turbofan) fleet that powers the Airbus A320neo have not affected the broader Pratt & Whitney franchise. Reflecting the company's confidence in its ability to deliver on the announced GTF accelerated inspection programme on time and budget, it also announced a USD 10 billion buyback programme, which has effectively set a floor on the stock's valuation.

American Tower, the mobile tower real estate investment trust (REIT), also traded higher during the month. It recovered 10%, following its recent sell-off on the back of higher interest rates in recent months. The company reported solid results in both its tower and data centre businesses. With the 5G rollout still in its early stages, it also stands to benefit from a long earnings runway. Our holdings in the spirits sector recovered as inventory levels across the value chain reached more normalised levels, though this remains an ongoing process with pockets of excess inventories remaining in some regions, as we have seen with *Diageo's* subsequent announcement of a slowdown in Latin America last week.

Thermo Fisher, the leading life sciences equipment and services company, was 12% lower as it lowered its annual guidance on the back of slower spending by biotech customers and lower Covid-related testing and vaccine revenue streams. We reduced our position in the company in January this year, anticipating that 2023 was going to be weaker and we stand ready to increase our exposure again once headwinds start to recede.

Multi-Asset Income

Further positive adjustments to growth expectations for the US economy triggered a sharp steepening of the US yield curve, which in turn increased the pressure on risk assets. As a result, our multi-asset income strategy fell -1.6% in US dollar terms for the month and is now up 6.1% year-to-date.

Equities were more volatile in October, losing 2.2% (up 12.7% year-to-date) despite a constructive earnings release season across most of our portfolio holdings. Our fixed income portfolio was down 1% (up 5.4% for the year) with the correction in US Treasury yields offsetting the positive idiosyncratic stories (*MHP* and *Kernel* by way of example). Our alternative funds lost 1.7% (down 4.9% year-to-date) partially due to higher yields but also negative developments at *Hipgnosis* (see below).

Equity holdings, both *Zoetis* (-9.5%) and *Siemens Healthine*r (-3.7%) were weaker despite there being no specific news and ahead of earnings releases, which brought good results and upgraded guidance for the outlook this year and next.

So far this year the fixed income portfolio has generated 6.6% of cash income yield, translating roughly into 4% at the overall strategy level. Although some of our portfolio holdings have seen some news-related volatility (*WOM*, *First Quantum, Unigel*, MHP and Kernel) our bond holdings more than offset the negative impact of the rise in yields.

Our investment trust investments also suffered from the rise in yields. More specifically, Hipgnosis (-12.7%) was affected by shareholders discontent around its proposed disposal of 29 music catalogues and the cancellation of a dividend. The proposal was overwhelmingly rejected by shareholders at an EGM and its chair was ousted. Despite all this, our analysis shows that its share price is trading at a substantial discount to fair value. A new chair and directors will launch a strategic review of the business and we expect positive news flow to support the share price from the current depressed level.

We expected a degree of macro-driven volatility but with signs that the US economy is starting to cool off, we feel that it is premature to look for a material weakening. We also believe that the Fed may decide not to raise rates further, as the full impact of previous tightening is still flowing through, although this does not mean rates will begin to fall either. We have reallocated some of our cash to higher-quality bonds to further improve the quality of the portfolio and to limit potential volatility ahead of the end of the year.

Emerging Market Bonds

Our Emerging Market Bond strategy was down -1.1% for the month and is now up 2.7% year-to-date, both in US dollar terms. Global risk sentiment was impacted by the continued steepening of the US Treasury curve on the back of the resilience of the US economy. Emerging market credit spreads widened marginally and traded just inside the historical average.

Interest rate volatility impacted our higher quality corporate bonds such as *Grupo Bimbo* (Mexico; consumer non-cyclical) given their longer duration. Importantly, Bimbo's underlying earnings highlight robust trends and profitability improved, net leverage remained stable, while the liquidity profile and amortisation schedule improved after prudent liability management.

There was further volatility in *Wom* (Chile, communications) amid refinancing efforts. Its CEO, who had led its initial success, returned to the company and is refocusing his attention on its core market, which had historically experienced strong growth. Meanwhile, *First Quantum Minerals* (Zambia, basic materials) faced uncertainty around its copper mine in

Panama following a series of protests in the country. Meanwhile, we realized profit in *MHP* (Ukraine; agro-industrial) following the tender offer to buy back its 2024 bonds.

The market is focused on economic growth with probabilities skewed towards a soft landing. The Fed recently kept interest rates unchanged for a second consecutive time, indicating a possible end to the monetary tightening campaign. This should be a supportive environment to generate returns primarily from income.

Today, our Emerging Market Bond fund offers a 12.1% p.a yield to maturity (in US dollar terms) with a relatively short duration of 3.5 years. This comprises a 7.7% p.a income yield, which provides a degree of visibility on future returns as well as capital appreciation potential given the average bond price is 84 cents on the dollar.

November 2023