

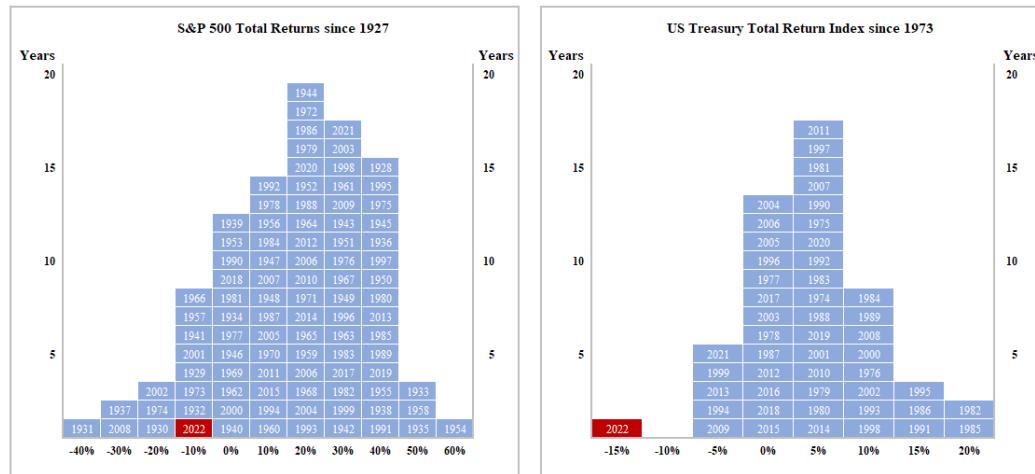
# J. STERN & CO.

*The Value of Long-Term Investing*

## Investment Commentary

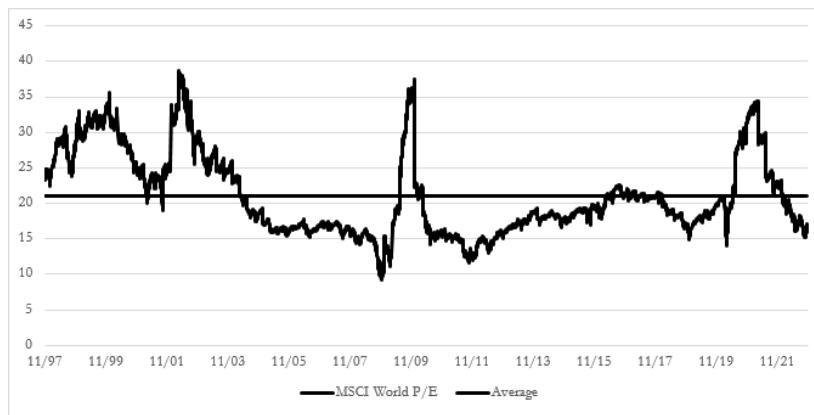
### IS THIS A MARKET TURNING POINT?

2022 has provided numerous challenges, as global markets have faced rising inflation and interest rates, supply chain bottlenecks and Russia's invasion of Ukraine. The result is a cocktail of negative sentiment, illustrated by the S&P 500 having one of its weakest years ever in US dollar terms, only topped by the Great Depression and the 2008 financial crisis. Bonds have performed even worse, with 2022 being the greatest yearly fall for US 10-Year Treasuries since records began. Never have both equities and bonds correlated so closely, showing little room for hiding in a tough market environment.



Source: Bloomberg as of 11/11/2022

However, it is important to look at the wider context in times of short-term volatility, and as long-term investors we view it as a rare opportunity to buy great companies at great prices. Our analysis of the World Stars portfolio shows a 2023 estimated P/E of 22.5x, close to its lowest level since the inception of the strategy back in 2012. This is mirrored by the MSCI World trailing P/E of 17.2x, 19% below its 25-year average of 21.1x. Despite this, many of our stocks continued to report positive earnings growth and excellent cost control in Q3 2022, painting a rather different picture of the economic environment. Combined with valuations at highly attractive levels, this presents a rare opportunity to invest in high quality companies.



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The question on everyone's mind is when the global equity market will start to sense the peak in inflation and hence the peak in rates; and start to look 'over the top' of the interest rate curve. The market is of course forward looking, but the extent of its forward vision varies according to the circumstances. In times of volatility/global uncertainty/turbulence the horizon comes back in, and myopia is more prominent. In calmer times the horizon moves out, confidence rises, and more value is placed on earnings and cash flow forecasts further out. This change in paradigm can affect quite sharp changes in mood/market interest. We feel that the peak of inflation and rates is now and that businesses with strong fundamentals and strong cashflow will begin to rerate.

Latest US CPI data suggests this is already happening, with 7.7% now its lowest point since January. This follows several other indicators that inflation has peaked, including encouraging PPI data out of China, showing signs that supply chain bottlenecks are beginning to ease. Now is the time for investors to look forward rather than back and take advantage of this rare opportunity.

Our Investment Insight this month is about one of these great companies: Walt Disney, the global media and entertainment company. We bought it in August of this year because we saw great value in its unrivalled franchises, channels, parks and resorts. Building on Mickey Mouse and his friends in the 1930s, Walt Disney has acquired and developed other franchises, including Star Wars, Marvel, Toy Story Frozen and many others, that have enduring appeal across generations. It has been able to monetize this content by releasing successful films and TV rights distribution along with advertising on its own TV channels including ESPN and others. Its latest Marvel blockbuster, Black Panther: Wakanda Forever set new box office records this month. Walt Disney has also successfully moved into streaming with Disney+. In two short years it has matched Netflix's subscriber numbers. Walt Disney's shares have been sold off over short-term concerns about costs as it invests in its streaming business and as its parks continue to recover from the pandemic. We think that streaming is one of the key value drivers for Walt Disney as Giles Tulloch argues in our Investment Insight. You can read it by following the link [here](#) or by clicking on the attachment.

## *World Stars Global Equities*

Global markets stabilized in October. Our World Stars Global Equities strategy closed the month up 4.2%. Its year-to-date performance year down -27.5% (both in US dollar terms) still reflects this year's significant market dislocation.

Performance was supported by positive quarterly earnings updates by many of our holdings, especially within the industrials sector.

Honeywell, the leading industrial software and technology solutions provider was up 22% during the month. The company is reaping the benefits of the recovery in the commercial aerospace and energy end markets, as well as the ongoing strength within the broader commercial construction market. The company's backlog, up 9% at \$29 billion, means that earnings remain well underpinned into next year. Medium-term Honeywell's next-generation offerings, including unmanned aviation, sustainable technologies, industrial automation and quantum computing, reinforce its through-the-cycle structural growth profile.

These positive messages were echoed across other holdings within the aerospace, electrical as well as connector and sensor industries, also fuelling their share prices. Swiss speciality chemicals manufacturer, Sika, provided a confident update at its annual capital markets day,

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providing more information on its role as an enabler in the construction industry's transition to net-zero, with products ranging from green roofs to concrete recycling solutions and sealing and thermal management offerings for electric vehicles. With the acquisition of global peer MBCC still expected to close in the first half of 2023 and strong short-term top-line momentum, reflected in the over 14% third-quarter organic growth, the stock was well supported, closing October up 13%.

Performance was also helped by news flow in the broader digital space. Payment network operator, Mastercard, posted an over 20% constant currency growth in its quarterly results, led by cross-border transaction volumes which grew over 40% as global travel activity continues to recover. The company also pointed to continued robust consumer spending trends, especially within the US, fuelling the stock up 15%.

Finally, creative software publisher, Adobe, provided a reassuring financial guidance update on its recent analyst day. It deepened the market's understanding of the strategic rationale for its acquisition of a web-design collaboration platform, Figma, and the breadth of associated cross-synergy opportunities, helping the stock recover by 16%.

On the negative side, social media industry leader Meta's share price came under significant pressure as the company announced a significant increase in its operating and capital expenditure. Guidance for 2023 rose to \$96-101 billion and \$34-39 billion up from low teens from guided 2022 levels respectively on the back of a step-up of investments in the metaverse. This overshadowed positive updates in other parameters of the business, which saw both Instagram and WhatsApp cross the two billion daily active user threshold.

Although we view the reaction to the stock price as extreme, we share the market's concerns around the company's capital allocation choices and overall governance which remain heavily influenced by Mark Zuckerberg's long-term vision for the company. Although it has served the company well in the past and helped to catapult it into its current leadership position, the more experimental nature of the intended metaverse investments increases the company's financial risk profile. Given these concerns, we were pleased to see the subsequent announcement by the company that it intends to reduce its workforce by 13% as well as moderate the level of planned capital expenditure in reflection of feedback from its shareholders. We will continue to monitor the news flow closely and to engage with the company, looking at all options including potentially exiting our position over the coming months.

## *Multi-Asset Income*

Against a difficult and volatile macro and geopolitical background, our multi-asset income portfolio recovered with a positive return of 2.1% and is now down -19.6% since the start of the year (both in US dollar terms) supported by a constructive earnings season. Equities were the main positive contributor up 6.7% for the month and are now down -26.8% for the year. By contrast, our fixed-income portfolio was down -0.4% and is now down -13.7% for the year. It faced rising US Treasury yields as most developed markets' central banks reaffirmed their outlook for higher interest rates to fight inflation. The non-correlated funds were also slightly weaker down -0.6% last month and down -13.7% year to date.

Although economic data was still at the forefront of investors' attention, corporate earnings were the main drivers. Data showed signs of a global economy slowing down but still resilient when the earnings, were by and large, better than expected (except for the technology sector).

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Of notice in the equity portfolio, Schlumberger released some very strong numbers and its share price reacted strongly and was up 44% over the month. Xylem, a recent addition, also delivered strong earnings with shares up 17% on the month.

The non-correlated funds benefited from bargain hunting as the new prime minister's government stabilised markets and forced selling by some UK institutions came to an end and from. Biopharma Credit announced a special dividend and was up 15.4% last month. Despite this strong recovery our portfolio was affected by revised valuations of some of the trade finance funds.

Although we should now be getting close to the last leg of the US Federal Reserve's interest rate increases, investors are mostly concerned by the possible impact of the economic slowdown on corporate profitability. With the third-quarter earnings season behind us and US mid-term elections resulting in divided government in the US, we may see some relief to risk assets before the end of the year. However, we still expect both volatile market conditions and opportunities in 2023.

## *Emerging Market Bonds*

Our Emerging Market Bond strategy was down -0.7% for the month in US dollar terms. Performance was driven by a combination of macro concerns including US interest rates, tightening liquidity and ongoing geopolitical risks. This led to further outflows from the emerging market asset class and is one of the reasons credit spreads widened 50 basis points during the month (170 basis points year to date) to 445 basis points. Credit spreads now trade about 100 basis points wide to the last 20-year average, levels reached only a handful of times over that period.

There were positive tailwinds for our corporates in the energy sector after OPEC+ endorsed steep cuts to its output targets, which helped oil prices rise 9% to \$86 per barrel. Meanwhile, Pemex (Mexico, energy) reported solid third-quarter results on the back of higher oil prices. Importantly, government capital contributions continue to finance capital expenditures and liquidity has improved with management discussing options for upcoming debt maturities.

There were positive endorsements of our investment thesis with credit rating upgrades to two holdings. Greenko (India, renewable energy) was recognised for its improving business position, stabilising operations, greater resource diversity and strong equity commitment. Meanwhile, Marfrig (Brazil; protein) was acknowledged for strong operating performance, expected positive free cash flow and low leverage.

On the downside, the main detractors were our Ukrainian companies given the ongoing military conflict. Nevertheless, MHP's (agro-industrial) monthly operational update once again illustrated a high degree of resilience with production volumes and most exports continuing despite war-related logistical challenges.

The Brazilian elections at the end of the month resulted in Leftist former President Luiz Inacio 'Lula' da Silva winning 50.9% of the presidential vote, the tightest margin in Brazil's history. Lula's election should see a move away from Bolsonaro's open-market economy to a more state-led approach.

Performance will continue to be driven by macro conditions and volatility will stay elevated until there are concrete signs that inflation is under control and the pace of monetary

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tightening slows. Credit fundamentals are strong and many companies have been proactive in terming out their debt maturities at low fixed rates, partially insulating them from the current rising rate environment. Emerging Market corporate default rates are at just 1.2% year to date (excluding specific areas like Chinese property and Russian issuers), which compares well to 1.5% in the US high-yield market.

This environment will continue to create opportunities for long-term investors to lock in attractive yields by buying and holding bonds to maturity. Today, our Emerging Market Bond strategy offers a 13% per annum total return yield to maturity (in US dollar terms) with a relatively short duration of four years. This comprises 8% per annum current yield (income) and 4% per annum capital appreciation potential.

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