*Investment Commentary*

## CHEER UP!

Jeff Prestridge, the long-time personal finance editor of the Mail on Sunday, has featured our analysis of the long-term returns offered by equities in this Sunday's newspaper. We were happy to engage with him because we think it is an important and powerful message to get out at this time of uncertainty and concern.

Our conviction is to invest in the stocks of companies that have quality and value for the long-term. When uncertainty is high and markets sell off as they have this year, it can be challenging to focus on the fundamental strength of companies, their sustainable competitive advantage and their potential for value creation.

We invest in companies not markets but it is a fact that equities as an asset class have performed strongly over decades and that they are the most liquid and most accessible way to preserve and increase the real value of assets over the long-term through inflation, geopolitical and macroeconomic uncertainty, economic cycles and other issues.

Our analysis of the long-term investment returns offered by equities shows that it is hard to find ten year periods in which investors did not generate returns of 8% per annum or more from investing in major markets.

We had an opportunity to share it with Jeff and hope that his article will help people to understand the importance of investing with a consistent and long-term approach, regardless of whether it is selecting companies as we do or investing in markets as a whole, with all the benefits and drawbacks that come with investing in index funds or ETFs.

You can read the article on the Daily Mail website by following the link here.

Buffeted by the pandemic and Russia's invasion of Ukraine, the US and European economies have been benefitting from strong demand for goods and services. However, at the same time, they are struggling with supply constraints for resources and labour and high energy prices. These constraints are the cause of the high inflation we are experiencing and have led the US Federal Reserve and other central banks to raise rates rapidly this year.

Growth, inflation and interest rate increases go hand in hand. In January 2020, just before the pandemic, US 10-year treasury rates were at 1.8%. Today they are at 3.9%.

Of course there is an impact from rising rates on consumers, corporates and investors. The sell-off in markets reflects those concerns. However, not all consumers are overleveraged or are facing increases in floating rate mortgages, not every country is reliant on imported natural gas at prices that have increased fourfold or more, not every corporate is overleveraged or reliant on public or private markets for their funding, and not every investor has invested in government bonds which they have leveraged through derivatives which require large amounts of collateral to be posted that cannot be raised through asset sales at a time of market stress as UK pension funds have. Just how damaging the impact will be on consumers in the US and Europe will become apparent by the end of the year.

However, as supply responds, bottlenecks ease, people re-enter the workforce, oil and gas prices level out or decline and as comparisons annualize, and as we hope for a peaceful resolution of the war in Ukraine, the picture could change quickly. A US economy with interest rates of 4.5%, inflation of 2-4% and 0-2% real rates is normal and nothing to worry about.

Many companies continue to have strong demand, especially in higher end consumer products, healthcare and life sciences and industrials. Our overview of our World Stars Global Equities strategy below provides several examples. We are invested in businesses that continue to grow, that have the innovation and competitive advantage to increase their prices to offset inflation, that have the scale and expertise to mitigate the cost increases in their purchasing and that have the financial strength to keep investing in their businesses, to buy others or to buy back shares.

It is time for investors to cheer up. One of our favourite Warren Buffett quotes is that it is better to buy a great company at a good price than a good company at a great price. Today's share prices mean we can buy great companies at great prices which we think offer great opportunities for long-term investors.

*World Stars Global Equity*

Our World Stars Global Equity strategy reflected the ongoing market sell-off during September. It closed the month down -9.5% and is now down -30.4% for the year, both in US dollar terms.

Despite the volatility, the majority of our holdings continued to show operational resilience. *Pernod Ricard*, the owner of iconic brands like Martell, Chivas and Absolut, reported strong results with 17% organic growth for the financial year 2022. This reflected continuing resilience in at-home consumption, the ongoing recovery in the on-trade and a rebound in duty-free purchases. Importantly, the company has seen no evidence of down trading with premium brands remaining in strong demand and spirits seen as an affordable indulgence even in times of tighter consumer spending. Its statement was echoed by peer Diageo in its latest trading update, helping support both stocks.

Pharmaceutical manufacturer *Roche* also defied the market volatility. During an investor day, it showcased the breadth and depth of its pipeline of new products for lung cancer and Alzheimer's. Although these products have a higher risk profile in terms of clinical trial results because of their highly innovative nature, they offer significant upside to market expectations if they are successful. A subsequent positive trial update by competitors Biogen/Eisai on an Alzheimer's drug with a similar mechanism of action helped fuel Roche's stock price higher.

However, other holdings, especially in the digital sector, came under renewed pressure as concerns over the pace of interest rate increases continued to dominate investor sentiment. Some of our holdings faced additional short-term headwinds too.

Creative software developer *Adobe* came under pressure despite reporting solid third-quarter results, following the announcement of the acquisition of Figma, a web design collaboration platform. The deal valued at US$20bn represents Adobe's largest acquisition to date and the company paid a full multiple for the asset at 50x 2023 annual recurring revenues. Inevitably in the current nervous market conditions, the high multiple and associated earnings dilution led to a sell-off of Adobe's stock on the day. Nonetheless, we believe that the acquisition makes sense allowing for significant cross synergies, whilst also enabling Adobe to use Figma's engineering talent to accelerate the development of its own web-based offerings.

Leading semiconductor manufacturer, *Nvidia*, also came under renewed pressure as concerns over slowing demand continued to weigh on the broader industry. We would note however that the company held its annual investor day in late September, presenting its next-generation products for gaming, data centres and automotives. Ultimately, Nvidia remains the undisputed leader in high-end semiconductors and is well-placed to take advantage of structural trends in artificial intelligence, cloud and edge computing as well as autonomous vehicles.

These are undoubtedly difficult markets, but we continue to focus on the fundamental quality and value of our investments. Our holdings are proving highly resilient against difficult and volatile macroeconomic conditions. They continue to deliver revenue growth supported by their exposure to robust structural trends and continue to benefit from strong pricing power and operational flexibility. This enables them to navigate through the current inflationary raw material and supply chain-constrained environment. Finally, our holdings continue to use their cash flow and balance sheets to make strategic investments to further entrench their long-term competitive position and to make strategic acquisitions and buybacks to take advantage of currently depressed share price levels.

*Multi-Asset Income*

Despite the previous month's weak performance, markets were still in a risk-off mood for September, with all asset classes coming under pressure. Our multi-asset income portfolio was not immune. It fell -6.3% during the month and is now down -21.1% since the start of the year, both in US Dollar terms. Equities again were the most volatile asset class showing a negative return of -10.5% (down -31.3% for the year). Although our fixed income portfolio was less affected it still was down -4% for the month (a negative return of -13% for the year). The non-correlated funds joined the other segments down -3.7% last month, for a negative performance year-to-date of -13.3%.

Economic data was the focus of attention again and investors had to digest central banks' aggressive efforts to tame inflation. The 10-year US Treasury yield rose sharply to reach almost 4% whilst the two-year and five-year yields were above 4%. Exchange rates (US dollar versus Euro and GBP) fluctuated widely, adding to the market stress. This was further compounded by more lockdowns in China. Such an environment provided little incentive to investors to increase risk.

The corporate news flow was mostly positive for our holdings but did not prevent increased volatility and profit-taking. There was positive news flow regarding *Siemens Healthineers* but this didn't prevent further share price weakness. We have taken the opportunity of currently weaker share prices to add *Walt Disney* and *Xylem* as new holdings in our portfolio. We intend to grow those positions further, markets allowing.

Following a counter-trend performance last month, the fixed income portfolio finally gave in to the general pressure despite limited or overall positive news flow. *Tullow Oil* was an exception to the rule (see below). Turkish bonds were still in demand and performed relatively well as investors decided to hunt for bargains. *MHP* and *Kernel*, our Ukrainian holdings benefited from encouraging developments on the war front.

The third quarter earnings season is fast approaching and should provide more clarity to market participants as to the level of economic slowdown. Following this last correction, asset classes are offering attractive entry levels for long-term investors. There could be more weakness but we are confident in the underlying fundamentals of our investments and their ability to sustain a challenging environment.

Our portfolio is currently yielding close to 5% and we firmly believe that this will provide downside support even if we witness further volatility.

*Emerging Market Bonds*

Our Emerging Market Bond strategy was down -4.3% for the month in US dollar terms as global risk sentiment weakened due to the increased probability of a near-term recession and continued monetary policy tightening. For context, all major fixed-income assets were impacted with US High Yield down -4.0% and US Investment Grade down -5.3%. Such an environment led to sizeable outflows from the emerging market asset class, which was partly responsible for credit spreads widening 30bps during the month (90 bps year-to-date) to 405 bps. Credit spreads now trade c.50 bps wide to the last 10 and 20-year averages. You can find the latest factsheet here.

There were few places to hide across geographies and sectors. Of note, some higher quality corporates such as *DP World* (UAE, consumer non-cyclical), *Grupo Bimbo* (Mexico, consumer non-cyclical) and *Millicom* (Colombia, communications) were most impacted by the interest rate volatility given their longer duration bonds, despite being in defensive sectors. Meanwhile, some of our companies are prudently looking to take advantage of the downward pressure on bond prices, launching tender offers to buy back debt and strengthen their balance sheet.

Aside from the broader market volatility, there were some positive underlying corporate events. First, *MHP* (Ukraine, consumer non-cyclical) reported second quarter results that were resilient, with most exports continuing despite war-related logistical challenges. The company also announced the resumption of coupon payments in full and on time, having previously been granted the flexibility to postpone debt service obligations after the Russian invasion. Second, *Alsea* (Mexico, consumer non-cyclical) was upgraded by two credit rating agencies endorsing our original thesis of improving operating results, leverage metrics and liquidity on the back of economic reopening across Latin America.

On the negative side, *Tullow Oil's* (Ghana, Energy) contemplated merger with Capricorn Energy fell apart following Capricorn's decision to pursue alternative deals. Whilst the deal was a positive catalyst, the original investment thesis remains intact with an operational turnaround, improved liquidity and near-term deleveraging.

Performance will continue to be driven by macro conditions and volatility is likely to continue, with the market continuing to shift its attention between concerns about the persistence of inflation and deep recession. Such an environment will continue to create opportunities for long-term investors focussed on strong underlying corporate fundamentals to lock in attractive yields by buying and holding bonds to maturity. Today, our Emerging Market Bond strategy offers a 12% p.a. yield to maturity (in US dollar terms) with a relatively short duration of four years. This comprises an 8% p.a. current yield (income) and 4% p.a. capital appreciation potential as the average bond price is 84 cents on the dollar, which implies 16 cents upside over the next four years as bond prices pull to par at maturity.

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